Office of the Comptroller of the Currency

Interpretive Letter #756

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November 5, 1996

12 U.S.C. 24(7)

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Re: Participation in a Limited Liability Company by the [ ], [city, state].

Dear [ ]:

This is in response to your letters of [date], 1996 and [date], 1996 to Michael Tiscia, Licensing Manager, Northeastern District, concerning a proposal by the [ ] (the "Bank") to purchase a minority interest in a limited liability company (the "LLC"), to be formed with an unaffiliated corporation ("Vendor") engaged in the development, distribution and maintenance of computer software for cash management applications. For the reasons given below, it is our opinion that this transaction is legally permissible as described herein.

Facts

Vendor is a privately held, domestic corporation that is engaged in the development, distribution and maintenance of cash management products and services software. Vendor's software products allow a bank's customers to directly access their bank accounts, to manage the flow of funds through their accounts more efficiently, and to perform a variety of funds transfer activities. Vendor products enable a bank to offer its customers alternative ways of making deposits to, and withdrawals from, deposit accounts. Generally, Vendor licenses its products to financial institutions, which then distribute the products to their customers. Vendor services its products under maintenance agreements with licensees. The Bank has been a licensee of Vender's products for [ ] years, and has distributed Vendor's products to a substantial number of customers. Over [ ] other banks, ranging in size from super-regional to small community bank, currently license Vendor products.

The Bank and Vendor will establish the LLC under [ ] law. Vendor will contribute substantially all of its operating assets (consisting primarily of intellectual property and equipment) and the related liabilities in return for a 68 percent ownership interest in the LLC. The Bank will contribute [$$] in exchange for a 32 percent interest in the LLC. The employees of Vendor will become employees of the LLC, and the

LLC will continue the business of Vendor. (**NOTE:** Vendor will retain its existing license/maintenance agreements and will continue to perform its obligations thereunder using employees supplied by the LLC. All revenue generated by such agreements will be remitted to the LLC. In addition, the President of Vendor and Vendor will enter into a non-compete agreement with the LLC for a specified term.) Also, in consideration of its investment in the LLC, the Bank and each of its existing affiliates (and certain future affiliates) will receive a [ ] license of all of Vendor's products. The license will include all enhancements to those products developed during a specified period, as well as maintenance and support for all such products [ ]. The Bank's system development, product design and technical resources may from time to time be used to assist the LLC in the development of new cash management products and services software.

The conduct of the business and affairs of the LLC will be governed by an operating agreement between Vendor and the Bank (the "Operating Agreement"). Under the terms of the Operating Agreement, the LLC has the option to redeem all or part of the Bank's investment in the LLC; the redemption price will be calculated to yield not less than a [%] return to the Bank, compounded from the date of the investment to the redemption date. The Bank will not have the authority to unilaterally trigger such a redemption. The Bank will have a right of first refusal to purchase any interest in the LLC offered for sale to any third party at the same terms as offered to or by the third party, subject to regulatory approval. The Operating Agreement prohibits the LLC from developing, engaging in, or acquiring any line of business that is not permissible for a national bank or that is not a part of the business of banking or incidental thereto.

The business and affairs of the LLC will be overseen by a Management Committee composed of five individuals. Two of these individuals will be designated by the Bank, and the remaining three individuals will be designated by Vendor (one of which cannot be an employee of Vendor, or related to an employee or stockholder of Vendor, or an employee or agent of any creditor or investor in Vendor). (**NOTE:** The Operating Agreement will provide that at least 80 percent of the Management Committee members must approve any change in control of the LLC, except that a change in control involving the sale by Vendor of its interest in the LLC may be approved by a simple majority of the board, subject to the Bank's right of first refusal and to the Bank's right to participate in the sale pro rata at the same price and terms offered to Vendor.) The Bank will only be permitted to designate one individual to the Management Committee if its investment in the LLC falls below [$$]. The Operating Agreement provides that it may only be amended with the unanimous consent of all members of the LLC.

The Bank believes that the driving force in the development of new and next generation cash management software is the need for products that are readily adaptable to many different host systems and that can be added to and upgraded in the future with minimal disruption to existing systems. The Bank anticipates that its investment will provide it with continued access to software products to support its cash management products, and have the opportunity to participate in the development of the next generation of cash management product software.

Analysis

In approving a national bank's majority participation in a LLC, the OCC has looked at whether the underlying activities are permissible under 12 U.S.C. § 24(Seventh) as part of or incidental to the business of banking, whether the national bank is shielded from unlimited liability for the acts of the LLC, and whether the national bank has the power to influence and, if necessary, withdraw from membership in the LLC in the event the LLC engages in activities which are impermissible for national banks. Separately, in a variety of circumstances the OCC has permitted national banks to own, either

directly, or indirectly through an operating subsidiary, a minority interest in an enterprise. The enterprise might be a limited partnership, a corporation, or in more recent examples, a limited liability company. In a recent interpretive letter, the OCC concluded that national banks are legally permitted to make a minority investment in a LLC provided four criteria or standards are met. *See* Interpretive Letter No. 692 *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995) and No. 694 *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995). (**NOTE:** In two other recent letters, the OCC has permitted national banks to make a non-controlling investment in an enterprise other than an LLC, provided the investment satisfies these four standards. *See* Interpretive Letter No. 697 *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,012 (November 15, 1995); Interpretive Letter No. 705 *reprinted in* [Current] Fed. Banking L. Rep. ¶ 81,020 (October 25, 1995).) See also Letter of Steven J. Weiss, Deputy Comptroller, Bank Organization and Structure (December 27, 1995 unpublished) ("Weiss Letter"). These standards, which have been distilled from our previous decisions in the area of permissible minority investments for national banks and their subsidiaries 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 or entity 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 a mere passive investment unrelated to that bank's banking business.

Applying these four standards to the facts presented, I conclude, as discussed below, that 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.*

The proposed activities of the LLC -- cash management software development, distribution and maintenance -- are legally permissible under 12 U.S.C. § 24 (Seventh) as part of the business of banking. It is well established that a national bank may use electronic means to perform services expressly or incidentally authorized to national banks. (**NOTE:** *See* OCC Interpretive Letter No. 677,*reprinted in*[1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995); OCC Interpretive Letter No. 284,*reprinted in*[1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,448 (Mar. 26, 1984); and OCC Interpretive Letter No. 449,*reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,673 (Aug. 23, 1988).) The OCC Interpretive Ruling setting forth this authority was recently revised, in recognition of the rapid advancement of technology, to authorize a national bank to "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide, or deliver." 61 Fed. Reg. 4849 (1996) codified at 12 C.F.R. § 7.1019. The OCC has long held that cash management services are part of the business of banking. (**NOTE:** Letter of Peter Liebesman, Assistant Director, LASD (August 15, 1983) (Unpublished) (the "Liebesman Letter"). Cf. Letter of John E. Shockey, Deputy Chief Counsel (December 23, 1975) (Unpublished) and OCC Interpretive Letter No. 419, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,643 (February 16, 1988).) Thus, a national bank may, as part of the business of banking, supply customers with cash management software and data processing services. (**NOTE:** *See* Letter of Peter Liebesman, Assistant Director, LASD (December 13, 1985) (Unpublished) (national bank may purchase, adapt, and market cash management software). *See also,* the Liebesman Letter, *supra* (national bank may provide cash management data processing services).) Similarly, a national bank may also develop and manufacture cash management software. (**NOTE:** *See* OCC Interpretive Letter No. 732 (May 10, 1996) (to be published) (national bank may acquire a minority interest in a firm that, inter alia, designs, develops, and markets software supporting electronic funds transfer and data interchange activities); Interpretive Letter No. 677, *reprinted in* [1994-95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995) (national bank operating

subsidiary may enter into a joint venture arrangement (through a limited liability company) to acquire MECA Software, Inc., a company that develops, produces, markets and distributes home banking and financial management software products designed to assist individuals and small business manage their finances through their personal computers).)

Here, Vendor's proposed cash-management software is substantially similar to the cash management software activities and services that have already been reviewed and approved by the OCC in prior interpretive letters. The proposed activities of the LLC are part of or incidental to the business of banking. Accordingly, this first standard is satisfied.

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.

As a corollary to the above, it is not sufficient that the LLCs' activities are permissible at the time the bank initially purchases LLC membership shares; they must also remain permissible for as long as the bank retains an ownership interest in the LLC.

Under [ ] law, a LLC may engage in "any lawful business, purpose or activity with the exception of the business of granting policies of insurance, or assuming insurance risks or banking as defined in [ ]. (**NOTE:** Banking is defined in [ ] as the "power of issuing bills, notes, or other evidences of debt for circulation as money, or the power of carrying on the business of receiving deposits of money." [ ]. In the course of its business activities the LLC will not engage in any of the foregoing activities.) The LLC Operating Agreement prohibits the LLC from engaging in any line of businesses that is not permissible for a national bank or that is not a part of the business of banking or incidental thereto. The Operating Agreement provides that it may only be amended with the unanimous consent of all members of the LLC. Therefore, since the Bank is a member of the LLC with the power to appoint two of the five members of the Management Committee, it will have the power to prevent the LLC from engaging in impermissible activities.

3. The bank's loss exposure must be limited 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, especially where an investing bank will not control the operations of the entity in which the bank holds an interest. It is important that a bank's investment not expose it to unlimited liability. Such is the case here. As a legal matter, investors in a [ ] LLC will not incur liability with respect to the liabilities or obligations of the LLC solely by reason of being a member or manager of the LLC. [ ]. (**NOTE:** The Operating Agreement specifically provides that "no . . . [m]ember shall be obligated personally for any such debt, obligation, or liability of the [Limited Liability] Company solely by reason of being a . . . [m]ember." Article II, § 11.1.) This limited liability feature is what differentiates LLCs both from general partnerships, where all partners are generally liable for the debts of the partnership, and from limited partnerships, which must have at least one general partner who is personally liable for the obligations of the partnership. (**NOTE:** The necessity for at least one general partner reflects a policy that someone have personal liability. *See* section 1 of the Uniform Limited Partnership Act. However, this is frequently circumvented in states where a corporation (with limited liability under state corporate laws) can be the general partner.) Thus, the Bank's loss exposure for the liabilities of the LLC will be limited by statute and the Operating Agreement establishing the LLC.

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 or investment in a LLC is to report it as an unconsolidated entity under the equity method of accounting. Under this method, 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. *See generally,* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Interpretive Letter 692, *supra.*

As proposed, the Bank will have a 32 percent ownership interest in the LLC, and will designate two out of five members of the Management Committee. The Bank believes, and its auditors will opine, that the equity method of accounting is appropriate in this instance because the Bank will not be able to control the LLC. Thus, the Bank's loss from an accounting perspective will be limited to the amount invested in the LLC as reflected on the Bank's books, and the Bank will not have any open-ended liability for the obligations of the LLC.

In addition, as noted above, [ ] law limits a members' losses to their capital investment and, therefore, the Bank will not have open-ended liability for the obligations of the LLC. Therefore, the third standard is satisfied.

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

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". *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). The provision in 12 U.S.C. § 24(Seventh) relating to the purchase of stock, derived from section 16 of the Glass-Steagall Act, was only intended to make it clear that section 16 did not authorize speculative investments in stock. *See* Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,012. Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to the bank in conducting that bank's banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.

Participation in the LLC will benefit both the Bank and its cash management operations. The Bank will acquire continued access to flexible, cost-effective and friendly software that will perform cash management product functions and applications. The Bank anticipates that this investment in the LLC will enable it to compete more effectively in the cash management products arena. The Bank will also benefit by being in a position to participate (through the LLC) in the development of the next generation of cash management product software. In addition, the Bank will receive a [ ] license of all of Vendor's products. The license will include all enhancements to those products developed during a specified period. Therefore, as a part of this process, the Bank's cash management operations will be continually upgraded and maintained. The use of this LLC to develop the next generation of cash management software gives the Bank access to technology owned by Vendor that might otherwise be unavailable to the Bank.

The Bank's investment in the LLC is not a speculative or passive investment. The Bank's investment in the LLC is related to its cash management business and would be convenient and useful to it in carry out its banking business. Therefore, the fourth standard is satisfied.

Conclusion

In sum, it is our opinion that the Bank is legally permitted to purchase minority interests in the LLC in the manner and as described herein, provided:

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 is inconsistent with condition number one, or will withdraw from the LLCs in the event they engage in an activity that is inconsistent with condition number one;
3. the Bank will account for the investment in the LLC under the equity method of accounting; and
4. the LLC will be subject to OCC supervision, regulation, and examination.

If you have any questions, please contact James Vivenzio, Senior Attorney, Northeast District at (212) 790-4010.

Sincerely,

/s/

Julie L. Williams
Chief Counsel