



Comptroller of the Currency
Administrator of National Banks

250 E Street, SW
Washington, DC 20219

Conditional Approval #582
April 2003

March 12, 2003

R. Patrick Lamb
General Counsel
First National Bank of Arizona
First National Bank of Nevada
14635 N. Kierland Boulevard, Suite 201
Scottsdale, Arizona 85252

Re: Operating Subsidiary and Non-Controlling Investment

First National Bank of Arizona, Scottsdale, Arizona
First National Bank of Nevada, Reno, Nevada
CAIS Control Numbers: 2003-WE-08-0004 and 2003-WE-08-0005

Dear Mr. Lamb:

This is in response to your operating subsidiary and non-controlling investment applications (collectively, the “Applications”), filed on behalf of First National Bank of Arizona, Scottsdale, Arizona (“FNB Arizona) and First National Bank of Nevada, Reno, Nevada (“FNB Nevada”) (collectively, “the Banks”) on January 15, 2003 and amended February 18, 2003.

FNB Arizona proposes to establish HMS, LLC, an operating subsidiary (“the subsidiary”), to engage in merchant processing activities through a new limited partnership, Humboldt Merchant Services, LP (“the LP”). The subsidiary will serve as the General Partner, and hold a 1% ownership interest in the LP. FNB Nevada will be a Limited Partner, and hold a 99% non-controlling ownership interest in the LP. Based on a thorough review of all information available, including the representations and commitments made in the Applications and by the Banks’ representatives, the Comptroller of the Currency (OCC) approves the Banks’ plan to conduct the merchant processing activities in the structure and manner described in the Applications, subject to the conditions described herein.

A. Background

The Banks have negotiated for the LP to acquire Merchant Bankcard Services (“MBS”) a proprietary merchant services division of Humboldt Bank, Eureka, California, a state-chartered bank.¹ MBS focuses on building a granular merchant portfolio consisting of many small merchant accounts with minimal contingent liability. Merchant applications are handled on-line through a software application that enables MBS’ sales force to review the application in real

¹ Currently, both banks engage in limited merchant processing activities.

time. Currently, the portfolio consists of approximately 8,000 active merchant accounts. MBS uses both in-house and independent contractors to sign up new merchants. These services fall under the broad category of merchant processing services, and involve verifying credit and debit card authorizations at the time of purchase, processing card transactions, settlement of card transactions, and depositing funds in merchants' accounts.

B. Analysis

Establishment of Operating Subsidiary to Engage in Merchant Processing Activities

Section 5.34(e) of the OCC's operating subsidiary regulation provides that "a national bank 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."² Clearly, merchant processing activities are permissible under 12 U.S.C. § 24 (Seventh), whether conducted directly or through operating subsidiaries.³ Additionally, it is long established OCC precedent that bank permissible activities may be conducted by operating subsidiaries through partnerships, joint ventures, and limited liability companies, and that national bank operating subsidiaries may act as managing general partner of the LP.⁴ In this case, the subsidiary will serve as the general partner of the LP, which will operate the merchant processing activities. The merchant processing activity is permissible for the subsidiary through the LP, because it is a permissible activity for the bank. Thus, FNB Arizona can establish the subsidiary to be the general partner of the LP and hold a 1% ownership interest in the LP.

Non-controlling Investment in a Limited Partnership

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.⁵ The OCC has concluded that national banks are legally permitted to make such a non-controlling

² 12 C.F.R. § 5.34(e)(1).

³ See, e.g., OCC Conditional Approval #248 (June 27, 1997); Interpretive Letter No. 720 (January 26, 1996), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,035; Interpretive Letter No. 689 (August 9, 1995), [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-004; Banking Bulletin 92-94, Merchant Processing (May 5, 1992).

⁴ See generally, OCC Interpretive Letter No. 423 (April 11, 1988), reprinted in Fed. Banking L. Rep (CCH) ¶ 85,647 (national bank operating subsidiary authorized to act as managing general partner of a limited partnership); OCC Interpretive Letter No. 289 (May 15, 1984) reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep (CCH) ¶ 85,453 (national bank permitted to become a limited partner in a banking-related venture).

⁵ See, e.g., Conditional Approval Letter No. 219 (July 15, 1996).

investment provided four criteria or standards are met.⁶ These standards 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 (or otherwise authorized for a national bank).*
- (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.*
- (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.*

We conclude, as discussed below, that FNB Nevada's non-controlling investment in the LP will satisfy these four criteria.

- 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.*

FNB Nevada proposes to make a non-controlling investment in a limited partnership engaged in merchant processing activities. These activities, as described by FNB Nevada, are well established as part of the business of banking and permissible for national banks under 12 U.S.C. § 24 (Seventh).⁷ Accordingly, the activities in which the LP will engage are part of, or incidental to, the business of banking. Thus, 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.*

This is an obvious corollary to the first standard. It is not sufficient that the entity's activities are permissible at the time a bank initially acquires its interest; they must also remain permissible for as long as the bank retains an ownership interest. The limited partner in which FNB Nevada will have a minority interest, will be prevented from engaging in impermissible activities because the general partner of the LP is the subsidiary which is wholly-owned by FNB Arizona. In addition, FNB Nevada has represented that it has the right to divest from the LP at any time. Accordingly, the second standard is satisfied.

- 3. The bank's loss exposure must be limited as a legal and accounting matter, and the*

⁶ See Interpretive Letter No. 692 (November 1, 1995); Interpretive Letter No. 694 (December 13, 1995).

⁷ See *supra* notes 3 and 4.

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 subject 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 the bank to unlimited liability. As a limited partner, FNB Nevada will not have open-ended liability for the obligations of the LP. FNB Nevada has represented that its loss liability for the LP will be limited to the amount of its investment. Thus, FNB Nevada's loss exposure for the liabilities of the LP will be limited by the Partnership Agreement and as a matter of law.

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 non-controlling ownership share or investment in an entity is to report it as an unconsolidated entity under the equity or cost method of accounting. You have represented that FNB Nevada will account for its ownership interest in the LP according to the equity method of accounting. Under the equity method of accounting, FNB Nevada's financial statement will reflect its investment in the LP. Investments made by the LP are not consolidated with assets held by FNB Nevada on its financial statement.

Therefore, for both legal and accounting purposes, FNB Nevada's potential loss exposure arising from its investment in the LP should be limited to the amount of its investment. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

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 business.

A national bank's investment in an enterprise or entity 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

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

⁹ See, *e.g.*, Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83, 225 (February 13, 1991); Interpretive Letter No. 427, *reprinted in* [1988-1989] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep.

In this instance, FNB Nevada's investment in the LP is not merely evidence of a passive relationship but is rather an effective and useful tool to FNB Nevada in carrying out its banking business. These benefits are convenient and useful to FNB Nevada in further developing its merchant processing business. Accordingly, the fourth standard is satisfied.

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, the OCC concludes that the Banks may proceed with their plans, subject to the following conditions:

1. No later than 90 days after consummating the acquisition of the merchant processing division of Humboldt Bank, and pursuant to the ownership sharing arrangement as outlined in your application, both FNB Arizona and FNB Nevada shall 1) develop a written capital plan acceptable to the OCC which adequately provides for capital support for the level of risk and sales volume associated with the merchant processing activities, and 2) obtain the OCC's written non-objection to the respective capital plans. The Board of Directors of each bank shall, at least quarterly, review and reevaluate the capital plan relating to merchant processing activities, and document in the Boards' minutes the conclusion as to that quarterly review.

At a minimum, the merchant processing capital allocation should provide for changes in sales volume so that capital support increases as sales volume increases. Other risk factors such as portfolio composition, charge-back trends, and loss trends should be evaluated to determine if higher levels of capital than minimums based on sales volume are needed. The merchant processing capital allocation is in addition to any capital needed to support other banking activities.

In connection with the application by FNB Nevada, to make a non-controlling investment in the LP, the approval is conditioned on the following:

2. The LP will engage only in the activities described in the Applications.
3. The LP will not engage in an activity that is inconsistent with Condition 2 without the prior written approval of the OCC.
4. FNB Nevada will account for its investment in the LP under the equity method of accounting.
5. The LP is subject to OCC regulation, supervision, and examination.

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In addition, with regard to FNB Arizona's formation of the subsidiary, and its actions as the general partner to the LP, the following condition applies:

6. The subsidiary, and the LP, may engage only in the activities described in the Applications and FNB Arizona must submit a notification or application to the OCC pursuant to 12 CFR 5.34 before engaging in activities not covered by the Applications.

These conditions are conditions "imposed in writing by the agency in connection with the granting of an application or other request" within the meaning of 12 U.S.C. § 1818 and, as such, are enforceable under 12 U.S.C. § 1818.

This conditional 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, the U.S., any agency or entity of the U.S., or any officer or employee of the U.S., and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the U.S.

A separate letter is enclosed requesting your feedback on how we handled your applications. We would appreciate your response so we may improve our service.

If you have any questions, please contact Licensing Manager James A. Bundy at (415) 545-5921.

Very truly yours,

Alan Herlands

Alan Herlands
Director for Licensing Operations