Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

April 30, 2000

Interpretive Letter #887
May 2000

Dear **[ ]**:

This responds to a letter written by **[ ]**, Esq., dated March 21, 2000, on behalf of **[ ]** (the "Bank"). **[ ]**'s letter requested confirmation that the Bank lawfully acquired a non-controlling interest in **[ ]** (" "), a **[*State*]** business trust established to purchase, own, and lease commercial aircraft. Subject to the conditions imposed below, we conclude that the Bank may hold this investment in **[ ]**.

Introduction

[ ] was established in April 1999 to purchase, own, and lease commercial aircraft. In May 1999, **[ ]** purchased a portfolio of 36 commercial aircraft and related leases from **[Co.]**.[1] **[ ]** financed the purchase by issuing approximately $1.2 billion in non-recourse debt and by selling its beneficial interest to a third party for approximately $40 million. The beneficial interest entitles the owner to any profits and any residual interest in the aircraft remaining after payment in full of all interest and principal on the debt. In October 1999, the Bank purchased, for $3.94 million, 5 percent of the beneficial interest in **[ ]** from the third party. The Bank expects to reflect income under Generally Accepted Accounting Principles (GAAP) – although the Bank has projected that it will not receive any actual cash distributions from **[ ]** until at least 2016 – and tax benefits from its ownership of the beneficial interest in **[ ]**.

Legal Discussion

The OCC has traditionally recognized the authority of national banks to organize and perform any of their lawful activities in a reasonable and convenient manner not prohibited by law. In

[1] **[Co.]** continues to service the aircraft leases.

interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in an enterprise provided four criteria or standards are met. 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:[2]

(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 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.

Based upon the facts presented, an investment in **[ ]**would appear to satisfy 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 (or otherwise authorized for a national bank).*

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 business of banking.[3] In the present case, **[ ]** engages in aircraft leasing, an activity permissible for national banks.[4] Thus, the first standard is satisfied.

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[2] *See* Interpretive Letter No. 694, *reprinted in* [1995 - 1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (Dec. 13, 1995); Interpretive Letter No. 692, *reprinted in* [1995 - 1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995); Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division (Apr. 28, 1988) (unpublished) (national bank may own minority interest in a business trust created to provide electronic data processing services).

[3] *See, e.g.*, Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (Dec. 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 (Nov. 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).

[4] *See* 12 C.F.R. Part 23 (1999).

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.*

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.[5]

The Amended and Restated Trust Agreement of **[ ]** ("Trust Agreement") limits **[ ]**'s activities to aircraft leasing and those activities necessary to engage in aircraft leasing. *See* Sections 2.03, 2.04(a), 5.02(e). Provisions of the Trust Agreement allow any beneficial interest holder to bring a proceeding to set aside and enjoin the performance of any activity not required or authorized by the Trust Agreement.[6] 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 unlimited liability. 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. In the case of a **[ ]** business trust, a beneficial interest holder's liability is limited by state law, and the Trust Agreement does not alter state law.[7] Thus, the Bank's loss exposure for the liabilities of **[ ]** is limited.

b. Loss exposure from an accounting standpoint

A national bank that acquires a five percent beneficial interest in **[ ]** should account for its investment using the equity method of accounting. 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. Thus, the Bank's loss from an accounting perspective will be limited to the amount invested in **[ ]**, and the Bank will not have any open-ended

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[5] *See, e.g.*, Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (Feb. 3, 1996); Interpretive Letter No. 625, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (Jul. 1, 1993).

[6] Additionally, the Bank has represented that it will dispose of its interest in **[ ]** if necessary.

[7] **[ ]** law provides that "[e]xcept to the extent otherwise provided in the governing instrument of the business trust, the beneficial owners shall be entitled to the same limitation of personal liability extended to stockholders of private corporations for profit organized under the general corporation law of the State." **[ ]** Code Ann. Tit. **[ ]**.

exposure to the liabilities of **[ ]**. Therefore, 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 banking business.

A national bank's investment in an enterprise or entity that is not a 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. 12 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]

A national bank's investment in **[ ]** may benefit or facilitate that bank's business in different ways. For example, a national bank's investment in **[ ]** would allow the bank to expand its business into new areas of banking – personal property leasing – by accessing the expertise of those with years of experience in aircraft leasing. Through this access, the bank would gain a level of experience which it may, in the future, leverage for its own benefit. Moreover, the investment in **[ ]** may allow the national bank to better manage its tax liability by deferring a portion of its federal income tax. In doing so, the bank may be able to conserve cash, to improve its liquidity, and to conduct its banking business more efficiently. Thus, the fourth standard is met.

Supervisory Concerns

Separate and distinct from the question of legal permissibility, the OCC also considers the safety and soundness of equity investments made by national banks.[10] If the OCC determines that an investment is not safe and sound for a particular national bank, it can require the bank to take such action with respect to that investment as is necessary to ensure that the institution operates in a safe and sound manner.

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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. 875 (Oct. 31, 1999) (to be published); Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (Feb. 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 (Mar. 14, 1988); Interpretive Letter No. 380, *supra.*

[10] Legal analysis and safety and soundness analysis are two different inquiries. Lending by national banks provides a good analogy to the present case. Making loans is clearly within a national bank's legal authority. However, loans must still be prudently made. If they are not, they may be criticized by examiners who can require the bank to classify the loans as losses.

In the present case, the OCC has determined that it is not consistent with safety and soundness for the Bank to account for the investment as an asset. The nature of the cash flow – the Bank has projected that it will not receive any actual cash flow from **[ ]** until at least 2016 – is distant and uncertain. For this reason, the Bank must charge-off its investment in **[ ]** in whole as of March 31, 2000. Should the Bank receive actual cash distributions from **[ ]** at some point in the future, the Bank may recognize these distributions as income.

Conclusion

For the reasons discussed above, we conclude that the Bank 's non-controlling minority interest in **[ ]** is permissible, and the Bank may hold this investment subject to the following conditions.

1. **[ ]** will engage only in activities that are permissible for a national bank.

2. The Bank will have veto power over any activities and major decisions of **[ ]** that are inconsistent with condition (1) above, or will dispose of its interest in **[ ]** in the event the enterprise engages in an activity that is inconsistent with condition (1) above.

3. The Bank must charge-off its investment in **[ ]** as of March 31, 2000. The Bank may recognize income from its investment in **[ ]** only when actual cash distributions are received from **[ ]**.

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

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.

This approval is granted based on a thorough review of all information available, including the representations and commitments made in the Bank’s letters and by the Bank’s representatives. If you have any further questions, you may contact Steven Key, Attorney, Bank Activities and Structure Division, at (202) 874-5300, or Maria Yee-Fong, National Bank Examiner, at (818) 240-9192.

Sincerely,

-signed-

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel