Comptroller of the Currency
Administrator of National Banks

Central District Office
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, Illinois 60605

October 14, 1997

Interpretive Letter #813
January 1998
12 U.S.C. 24(7)23C

Dear [ ]:

This is in response to your letter dated August 29, 1997, supplemented by letters dated September 22, 1997 and October 8, 1997, requesting confirmation that [ ], [*City, State*] ("Bank") may lawfully acquire and hold a non-controlling minority interest in a limited liability company ("LLC") which will engage in the business of merchant credit and debit card processing. 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 hold a 49 percent non-controlling interest in a newly-formed LLC. [ ] ("*Co.*") will acquire and hold the remaining 51 percent interest in the LLC. The LLC will be established under Wisconsin law pursuant to a written agreement between the Bank, [*Co.*], and [ ], [*City, State*] ("*Affiliate*"), an affiliate of the Bank. Initially, the Bank and [*Affiliate*] will organize the LLC and each will contribute their merchant processing assets to the LLC in exchange for a 99% interest and a 1% interest, respectively, in the company. Immediately following the establishment of the LLC, [*Co.*] will purchase all of [*Affiliate*]'s interest in the LLC, and enough of the Bank's interest in the LLC so that [*Co.*] will hold a 51% in the LLC and the Bank will own a 49% interest.

The LLC will be governed by an Operating Agreement between the Bank and [*Co.*]. Under the terms of the Operating Agreement, the LLC's manager is specifically prohibited from causing the company to engage in activities that would be impermissible for the Bank or a subsidiary of the Bank. Moreover, the Bank will have the authority to veto decisions of the LLC manager that will result in the company engaging in activities that are inconsistent with activities that are part of, or incidental to, the business of banking. The Bank is also authorized to terminate the Operating

Agreement and dispose of its interest in the LLC in the event the company engages in activities in which the Bank or a subsidiary of the Bank may not engage.

The LLC will provide debit and credit card processing products and services to merchants, including commercial loan and deposit customers of the Bank. Initially, the LLC will be staffed only by members of the Management Committee. All other operations of the LLC will be conducted by the Bank, [*Co.*], or third party vendors pursuant to contracts with the LLC. The Bank and its affiliates will generate new agent bank contracts and merchant processing arrangements for the benefit of the LLC. Furthermore, the Bank will enter into an agreement with the LLC to provide banking and related services to the LLC, such as serving as the member bank for Visa, MasterCard and other payment networks on behalf of the LLC. Pursuant to a long-term exclusive processing arrangement, [*Co.*] will provide back room processing services to the LLC.

II. Discussion

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

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. The enterprise might be a limited partnership, a corporation, or a limited liability company.[1] In recent interpretive letters, the OCC concluded that national banks are legally permitted to make a non-controlling investment in a limited liability company provided four criteria or standards are met. *See* Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007, and No. 694 (Dec. 13, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009.[2] *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 non-controlling 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

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[1] *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.

[2] In 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 e.g.* Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012; Interpretive Letter No. 705 (October 25, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81,020.

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, 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. *See, e.g.*, Interpretative 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).

The LLC will provide merchant credit and debit card processing services. It is clear that merchant processing activities are permissible under 12 U.S.C. § 24(Seventh).[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). Therefore, this 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.

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. *See, e.g.*, Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 3, 1996); Interpretative Letter No. 625, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993). This ensures that the bank will not become involved in impermissible activities.

Pursuant to the proposed Operating Agreement, the LLC is prohibited from engaging in activities which would be impermissible for the Bank or a subsidiary of the Bank. Also, the Bank will have

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[3] Merchant processing generally involves verifying credit and debit card authorizations at the time of purchase, processing card transactions, settlement of card transactions, and depositing funds in merchants' accounts.

the authority to veto activities or decisions by the LLC's manager that are inconsistent with activities that are part of, or incidental to, the business of banking, as determined by the OCC. This provision will enable the Bank on an ongoing basis to prevent the LLC from engaging in new activities which may be impermissible. Furthermore, the Operating Agreement authorizes the Bank to terminate the agreement and dispose of its interest in the LLC if the company engages in any activities that are not part of, or incidental to, the business of banking.

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, investors in a Wisconsin limited liability company will not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Wis. Stat. Ann. § 183.0304 (West Supp. 1996). Thus, the Bank's loss exposure for the liabilities of the LLC 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 20-50 percent ownership share of investment in a limited liability 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 are generally limited to the amount of the investment, including loans and other advances 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 No. 692, *supra.* Similarly, under the cost method of accounting, the investor records an investment at cost, dividends or distributions from the entity are the basis for recognition of earnings, and losses recognized by the investor are limited to the extent of the investment. In sum, regardless of which accounting method is used, the investing bank's potential loss is limited to the amount of the investment.

As proposed, the Bank will have a 49 percent ownership interest in the LLC. The Bank will account for its investment in the LLC under the equity method. Thus the Bank's loss from an accounting perspective would be limited to the amount invested in the LLC and the Bank will not have any open-ended liability for the obligations of the LLC.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure relative to the LLC 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. *See, e.g.*, Interpretative Letter No. 697, *supra*; Interpretative Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); Interpretative Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretative Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); Interpretative Letter No. 380, *supra*.

The Bank is currently actively involved in providing merchant processing services of the same or similar type as the LLC will provide. The Bank believes the best way for it to continue to provide merchant processing services is to enter into an alliance with another merchant processing provider, thereby achieving economies of scale necessary to lower per-transaction costs and other competitive advantages. [*Co.*] is a leading provider of merchant processing services, and the Bank believes its participation in this joint venture will help ensure the investment in technology needed to achieve economies of scale that the Bank could not achieve on its own. Thus the investment is "necessary" to the Bank's ability to efficiently and capably carry out its banking business and to compete more effectively in the merchant processing services market.

For these reasons, the Bank's investment in the LLC is convenient and useful to the Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, it is our opinion that the Bank is legally permitted to acquire and hold a non-controlling minority interest in the LLC in the manner and as described herein, subject to the following conditions:

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 are inconsistent with condition number one, or will withdraw from the LLC in the event they engage in an activity that is inconsistent with condition number one;

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

4. the LLC will be subject to OCC supervision, regulation, 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.

If you have any questions, please contact me or Christopher Sablich, Senior Attorney at (312) 360-8805.

Sincerely,

/s/

Coreen S. Arnold
District Counsel