Comptroller of the Currency
Administrator of National Banks

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

September 28, 1998

Interpretive Letter #842
November 1998
12 U.S.C. 24(7)

Dear [ ]:

This is in response to your letter to the Office of the Comptroller of the Currency ("OCC"), dated September 14, 1998, requesting confirmation that [ ] ("Bank") may lawfully acquire and hold a non-controlling 50 percent interest in a limited liability company with a vendor which is currently engaged in the services enumerated hereafter. The limited liability company will be structured as a joint venture ("Joint Venture"), and it will engage in title insurance agency, loan closing and other activities in connection with consumer purpose and commercial loans made by the Bank or the Bank's lending affiliates.[1] For the reasons set forth below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

PROPOSAL

The Bank proposes to hold a 50 percent non-controlling interest in a newly-formed Joint Venture. The other 50 percent equity owner will be a vendor ("Vendor") which currently offers most of the services which will be performed by the Joint Venture. The Joint Venture will be established under [*State*] law pursuant to a written agreement. The Joint Venture will be located in [*City, State*], a place of less than 5,000 (as measured by the 1990 census) in which the Bank operates a branch.

[1] The Letter states that the Joint Venture will initially provide services for the Bank and its affiliates only. At some future time, the Joint Venture may market its services to unaffiliated lenders, including other banks, thrifts, credit unions, mortgage companies, and finance companies, much as the Bank provides certain other services to unaffiliated institutions as correspondent.

The Joint Venture will be capitalized in cash equally by the Bank and the Vendor. It will hire its own employees who will not be dual employees of the Bank or the Vendor. The employees may or may not have a prior connection with the Bank or Vendor.

The Bank proposes, through this investment, to engage in the same eleven activities, subject to the same conditions and limitations, as the OCC reviewed and approved on May 8, 1998 in an application submitted by Mellon Bank, N.A., Pittsburgh, Pennsylvania.[2] The only structural difference between the current proposal and the Mellon application lies in the fact that Mellon established an operating subsidiary to hold the 50% interest in the joint venture. All other aspects of the Mellon proposal and this proposal are identical, including management structure of the joint venture and services to be provided.

The services that will or may be in the future provided by the Joint Venture are: (1) appraisal management; (2) title insurance agent activities; (3) closing management; (4) flood insurance services; (5) credit reporting; (6) property inspections; (7) property preservation services; (8) loan document preparation; (9) providing census tract and related property information; (10) portfolio audits; and (11) real estate tax services.[3]

Initially, the Joint Venture intends to perform only title insurance agent activities and closing management services. These services will be offered only in [*State*] for the foreseeable future. In most cases, these activities and services will be performed by employees of the Joint Venture. When the Joint Venture seeks outside employment assistance, it will subcontract the work to a qualified person or entity under an independent contractor relationship.

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[2] *See* OCC Conditional Approval No. 276 (May 8, 1998). With respect to the title insurance agency activity, for example, the Joint Venture will act only as a title insurance agent and in no event will it become obligated as an insurer. The Bank states that the services offered will conform to the guidance set out by the OCC in Interpretive Letter No. 753, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-107 (November 4, 1996).

[3] Some of the proposed services qualify as "settlement services" under the Real Estate Settlement Procedures Act ("RESPA") and, as such, the referral of the services among the Bank and its lending affiliates ("Lenders") and the Joint Venture are subject to the restrictions relating to "Affiliated Business Arrangements," as defined in the RESPA. The Bank has represented that the Lenders and the Joint Venture will comply with all applicable requirements of the RESPA with respect to the operation of the Joint Venture, including the Affiliated Business Arrangement rules. Specifically, neither the Lenders nor the Joint Venture will require a consumer to purchase settlement services from the Joint Venture as a condition of obtaining a loan from the Lenders, unless expressly authorized by the RESPA. In addition, the Bank has represented that consumers will be provided with an Affiliated Business Arrangement notice in the circumstances required by the RESPA. The Joint Venture will observe and abide by the RESPA's rules regarding the payment of a thing of value within the Affiliated Business Arrangement setting. The Lenders and the Joint Venture will also comply with the anti-tying restrictions found in the Bank Holding Company Act, 12 U.S.C. § 1972, to the extent applicable.

ANALYSIS

Investment by a Bank in a Limited Liability Company

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.[4] In recent interpretive letters, the OCC has 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.[5] 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 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.[6]

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.*

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[4] *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.

[5] *See* Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995), and No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995). *See also* Letter of Steven J. Weiss, Deputy Comptroller, Bank Organization and Structure (December 27, 1995 unpublished) ("Weiss Letter"). 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, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012 (November 15, 1995); Interpretive Letter No. 705, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,020 (October 25, 1995); Weiss Letter, *supra*.

[6] *See* OCC Conditional Approval No. 276 (May 8, 1998) and OCC Conditional Approval No. 243 (May 9, 1997).

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.[7]

As recited in the **Proposal** section above, the Bank is proposing through this Joint Venture investment to engage in the same eleven (11) activities that the OCC approved Mellon Bank, N.A., Pittsburgh, Pennsylvania on May 8, 1998.[8] Approval was granted to Mellon, subject to the same conditions set out in the **Conclusion** section below**,** after it was determined that these activities are part of or incidental to the business of banking.

Accordingly, 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.

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.[9] This ensures that the bank will not become involved in impermissible activities.

Pursuant to the Joint Venture Agreement, the Joint Venture is prohibited from engaging in activities which would be impermissible for the Bank. Also, the Bank, through its representation on the management committee of the Joint Venture, will have the authority to veto activities or decisions by the Joint Venture 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 Joint Venture from engaging in new activities which may be impermissible. Furthermore, the Joint Venture Agreement authorizes the Bank to terminate the Agreement and dispose of its interest in the Joint Venture 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.

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[7] *See, e.g.*, Interpretive 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).

[8] *See supra* n. 2.

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

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 [ ] 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.[10] The Bank asserts that the Joint Venture will be adequately capitalized by the Bank and the Vendor. The Bank and the Joint Venture will adhere at all times to corporate and other applicable formalities so that the Bank will maintain its corporate existence separate from the Joint Venture. The Joint Venture Agreement will not contain any clauses making the Bank liable for any obligations of the Joint Venture, nor will the Bank guarantee or otherwise assume any liabilities of the Joint Venture. Thus, the Bank's loss exposure for the liabilities of the Joint Venture will be limited solely to its capital contribution.

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 on an unconsolidated basis. 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.[11] As noted above, the Bank and the Joint Venture will adhere to all corporate formalities and the Bank will neither guarantee nor assume any liabilities of the Joint Venture. Consequently, the corporate veil so derived, and the use of the equity method of accounting, will protect the Bank from potentially open-ended exposure to the liabilities of the Joint Venture.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure relative to the Joint Venture should be limited to the amount of its investment in those entities. Because the Bank will not have open-ended liability for the liabilities of the Joint Venture and its potential 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.*

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[10] *See* [*State*] Comp. Laws Ann. § [ ].

[11] *See generally,* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Interpretive Letter No. 692, *supra.*

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."[12] 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.[13]

The services in question are of the types routinely purchased or performed by the Bank and its lending affiliates when engaged in the business of making mortgage loans and, as proposed to be conducted by the Joint Venture, will provide a useful and convenient source of these essential services that are ancillary to extending credit secured by real estate. Conducting the services by means of the Joint Venture will enhance the ability of the Bank and its lending affiliates to offer their mortgage loans more efficiently and capably to the public from a one-stop source while generating additional revenues for themselves. For these reasons, the investment is convenient and useful to the Bank in carrying out its lending business and is not a mere passive investment.

Thus, the fourth standard is satisfied.

A final condition relating to this type of proposal is that the Joint Venture will be subject to OCC examination. The Joint Venture Agreement provides for such oversight and, thus, this condition is met.

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 Joint Venture in the manner and as described herein, subject to the following conditions:

1. the Joint Venture 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 Joint Venture that are inconsistent with condition number one, or will withdraw from the

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

[13] *See, e.g.*, Interpretive Letter No. 697, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 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 (March 14, 1988); Interpretive Letter No. 380, *supra.*

Joint Venture 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 Joint Venture under the equity method of accounting; and

4. the Joint Venture will be subject to OCC 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.

If you have any further questions, you may contact me or Joseph Pogar, Jr., Senior Counsel, in the Central District at (312) 360-8805.

Sincerely,

/s/

Coreen S. Arnold
District Counsel