Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #269
February 1998

January 13, 1998

Ms. Carolyn E. Cheverine
Vice President and Associate Counsel
KeyCorp
127 Public Square
Cleveland, Ohio 44114-1306

Dear Ms. Cheverine:

This is in response to your application dated December 15, 1997 on behalf KeyBank, N.A., Cleveland, Ohio ("Bank") to establish an operating subsidiary which will acquire and hold a non-controlling minority interest in a limited liability company ("LLC"). The LLC will engage in the business of merchant credit and debit card processing, and will also lease point-of-sale terminals to merchants. For the reasons set forth below, we approve the establishment of the operating subsidiary by the Bank, subject to certain conditions.

I. Background

The Bank proposes to establish a wholly-owned operating subsidiary, Key Payment Services, Inc. ("Key Payment") which will hold a 49 percent non-controlling interest in a newly-formed LLC, Key Merchant Services, LLC ("LLC"). Nova Information Systems, Inc. ("Nova") will acquire and hold the remaining 51 percent interest in the LLC. The LLC will be established under Delaware law pursuant to a written agreement between the Bank, Nova, and NOVA Corporation (the holding company of Nova). Initially, the Bank and POS Sales and Services, Inc., a wholly-owned subsidiary of the Bank ("POSSI"), will organize the LLC. The Bank will transfer some of its merchant processing assets to Key Payment, and then Key Payment, the Bank, and POSSI will each contribute their merchant processing assets, including merchant agreements and equipment leases, to the LLC in exchange for a 49% interest, 46.8%, and 4.2% interest, respectively, in the company. Immediately following the establishment of the LLC, Nova will purchase all of the Bank's and POSSI's interest in the LLC so that Nova will hold a 51% in the LLC and Key Payment will own a 49% interest.

The LLC will be governed by an Operating Agreement between Key Payment and Nova. Among other things, the terms of the Operating Agreement provide that for as long as the Bank maintains a national bank charter, the LLC will not engage in any activities that are not permitted for national banks or entities in which national banks may invest. Also, the LLC will be managed by a Management Committee comprised of five members -- Nova will have the right to designate three committee members and Key Payment will have the right to designate two committee members. Pursuant to the Operating Agreement, significant decisions of the LLC, including changing the purpose of the LLC or conducting any business other than merchart card processing, will require (1) the affirmative vote of a majority of the Management Committee members, and (2) the affimative vote of a Management Committee member designated by each of Nova and Key Payment.

The LLC will provide debit and credit card processing products and services to merchants, including existing customers of the Bank. The LLC will also lease and install point-of-sale terminals.[1] The Bank will enter into an agreement with the LLC to provide clearing, settlement, marketing and other related services to the LLC. Pursuant to processing agreement, Nova will provide processing services to the LLC.

II. Discussion

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

A national bank may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(d)(1). To qualify as an operating subsidiary, the parent bank must own at least 50 percent of the voting stock of the corporation. 12 C.F.R. § 5.34(d)(2). Whether conducted directly or through operating subsidiaries, merchant processing activities are part of, or incidental to, the business of banking under 12 U.S.C. § 24(Seventh). *See, e.g.*, Conditional Approval Letter No. 248 (June 27, 1997); Interpretive Letter No. 689 (August 9, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-004; Banking Bulletin 92-24, Merchant Processing (May 5, 1992). Leasing of point-of-sales terminals in accordance with the requirements of 12 C.F.R. § 23, and activities incidental thereto, is a permissible activity pursuant to 12 U.S.C. § 24(Seventh) and(Tenth). *See M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (1977), *cert. denied* 436 U.S. 956 (1978). Therefore, the Bank may establish Key Payment as an operating subsidiary pursuant to 12 C.F.R. § 5.34.

The remaining issue presented by your notice concerns the authority of a national bank to hold--indirectly through an operating subsidiary--a non-controlling interest in an enterprise such as the LLC. A number of recent OCC Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in a limited liability

[1] The Bank represents that the leasing activities of the LLC will be conducted in accordance with the requirements of 12 C.F.R. § 23.

company. *E.g.*, Conditional Approval Letter No. 248, *supra;* Interpretive Letter No. 694 (December 13, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-009; Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-007. These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[2] They 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 entity or enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw from 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.

In addition, the OCC has also 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.*, Conditional Approval Letter No. 200 (April 12, 1996); Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996); 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. Each of these four factors is discussed below and applied to your proposal.

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 stock ownership have recognized that the enterprise in which the bank takes an equity interest must confine its activities to those that are part of, or incidental to, the business of banking. *See, e.g.*, Interpretive Letter No 380 (December 29, 1986), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85-604 n.8 (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services); Letter of 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).

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[2] *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.

The LLC will provide merchant credit and debit card processing services. Such activities are part of, or incidental to, the business of banking under 12 U.S.C. § 24(Seventh).[3] *See*, *e.g.*, Conditional Approval Letter No. 248, *supra*; Interpretive Letter No. 689, *supra*; Interpretive Letter No. 720 (January 26, 1996), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-035; Banking Bulletin 92-24, *supra.* Also, the LLC will lease and install point-of-sale terminals.[4] The leasing of point-of-sales terminals in accordance with the requirements of 12 C.F.R. § 23, and activities incidental thereto, is a permissible activity pursuant to 12 U.S.C. § 24(Seventh) and (Tenth).

Thus, with respect to the LLC, 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.

This is an obvious corollary to the first standard. 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.

Several provisions in the LLC Agreement ("the Agreement") are designed to satisfy the requirement that the LLC's activities remain part of, or incidental to, the business of banking. The Agreement provides explicitly that, for as long as the Bank maintains a national bank charter, the LLC will not engage in any activities that are not permitted for national banks or entities in which national banks may invest. Furthermore, any change in the activities of the LLC will require the consent of at least one of Key Payment-designated Management Committee members. As a result, the Bank, through its operating subsidiary, Key Payment, will be able on an on-going basis to prevent the LLC from engaging in new activities that are not part of, or incidental to, the business of banking. Thus, with respect to the LLC, this standard is met.

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

[4] The LLC-owned point-of-sale terminals will be generally available to customers of other banks, and will provide similar services on substantially similar terms and conditions for the accounts of the Bank's customers as well as accounts held by noncustomers, therefore, those terminals are not considered branches of the Bank. *See* Interpretive Letter of Eric Thompson, Director, Bank Activities and Structure, to Joseph T. Green, General Counsel, TCF National Bank Minnesota (November 3, 1997) (offices of a national bank's subsidiary at which loans are closed, where such loan closing services are provided on substantially similar terms and conditions to bank customers as well as customers of unaffiliated entities, are not bank branches) (unpublished); *see also* 61 Fed. Reg. 60,342, 60,347 (November 27, 1996). In addition, the operations of an entity in which a national bank has a non-controlling interest are not ordinarily attributed to the bank for branching purposes. *See* Interpretive Letter 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23, 1996).

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 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 a national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Delaware limited liability company do 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. Del. Code Ann. Tit. 6 § 18-303 (1994).[5] Thus, the Bank's loss exposure for the liability of the LLC is limited by statute and by the 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 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). *See also* Interpretive Letter 692, *supra.*

As proposed, the Bank will have a 49 percent ownership interest in the LLC through Key Payment. The Bank believes, and its internal accountants have advised, that the appropriate accounting treatment for the Bank's investment is 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. In addition, as noted above, Delaware law limits members' losses to their capital investment. Therefore, with respect to the LLC, 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 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

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[5] Section 3.08 of the Operating Agreement provides that "[n]o Member, as a Member, shall be liable for the debts, obligations or liabilities of the [LLC], including under any judgment, decree or order of any court."

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). Section 24(Seventh) does not authorize national banks to engage in speculative, investment banking activities with respect to stock. *See* Interpretive Letter No. 697, *supra*. Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to *that bank's* banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See e.g.*, Conditional Approval Letter No. 248, *supra*; Conditional Approval Letter No. 200, *supra*; Interpretive Letter No. 543 (February 13, 1991), *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83-225.

Acquiring and holding (through Key Payment) a non-controlling interest in the LLC will benefit the Bank in carrying out its business. Nova is one of the leading providers of merchant processing services in the United States, and so its participation in this joint venture will help ensure the investment in technology needed to offer the Bank's customers state-of-the-art merchant products and services. Furthermore, in addition to enhancing the Bank's existing merchant processing business, the opportunity to cross-sell other bank products will also be convenient and useful to the Bank in carrying out its other banking business. Thus, the investment is "necessary" to the Bank's ability to carry out its banking business efficiently and capably and to compete 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 investments. Thus, the fourth standard is satisfied.

D. CONCLUSION

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may establish Key Payment as an operating subsidiary and hold, through Key Payment, a 49 percent interest in the LLC. Our conclusion is conditioned upon the Bank's compliance through Key Payment with 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, through Key Payment, will have veto power over any activities and major decisions of the LLC that are inconsistent with condition number one, or withdraw from the LLC in the event it engages in an activity that is inconsistent with condition number one;

(3) The Bank, through Key Payment, will account for the investments in the LLC under the equity method of accounting; and,

(4) Key Payment and 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.

This approval is granted based on a thorough review of all information available, including the representations and commitments made in the application by the Bank's representatives.

If you have any questions, please contact Christopher G. Sablich, Senior Attorney, Central District, at (312) 360-8805 or Carolina Ledesma, Licensing Analyst, at (312) 360-8867.

Sincerely,

/s/

Julie L. Williams
Chief Counsel

ACN #97 CE 08 0052