Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #270
February 1998

January 21, 1998

Mr. Robert L. Anderson
Senior Vice President and Assistant General Counsel
First Union Corporation
Legal Division
One First Union Center
Charlotte, North Carolina 28288

Re: Application of First Union National Bank, Charlotte, North Carolina (Bank) to Acquire Certain Subsidiaries of Wheat First Butcher Singer, Inc. (WFBS) and for a Bank Operating Subsidiary to Retain a Non-Controlling Minority Interest in Mentor Perpetual Advisors, L.L.C. - Application Control Numbers 97-ML-08-026 and 028

Dear Mr. Anderson:

This is in response to your letter dated October 27, 1997 (Letter) relating to the acquisition of WFBS by First Union Corporation (First Union), the Bank's parent, and the subsequent transfer of certain WFBS subsidiaries by First Union to the Bank. Your letter requests Office of the Comptroller of the Currency (OCC) concurrence that the Bank's acquisition of six WFBS subsidiaries does not require notice or application under 12 C.F.R. Part 5 because these subsidiaries will engage in activities for which the Bank has previously received OCC authority. Your letter also seeks OCC approval for the Bank to acquire as operating subsidiaries three WFBS subsidiaries engaged in activities previously approved by the OCC for other national banks. Finally, your Letter describes a proposed purchase by a Bank operating subsidiary of a non-controlling minority interest in Mentor Perpetual Advisors, L.L.C. (MPA), a Virginia limited liability company (LLC) that is registered under the Investment Advisors Act of 1940 (1940 Act).

We agree with your conclusion that no application is required for the Bank's acquisition of additional subsidiaries that will engage in activities previously approved for the Bank by the OCC. We also approve your operating subsidiary notices for three operating subsidiaries to engage in new activities not previously approved for the Bank but approved for other national

banks. Finally, your application to acquire, through an operating subsidiary, a non-controlling minority interest in an investment advisory LLC is approved, subject to the conditions set forth herein.

I. BACKGROUND

A. Proposed Operating Subsidiaries

Following First Union's acquisition of WFBS, First Union plans to transfer the shares of the following entities to the Bank. Each of these entities would become Bank subsidiaries, or subsidiaries of Bank subsidiaries, and would be controlled by the Bank. As described in the Letter, each of these entities will engage solely in activities previously approved by the OCC for the Bank or other national banks to conduct in an operating subsidiary.

1. Mentor Investor Group, L.L.C. (MIG)

MIG is a Virginia LLC, registered under the 1940 Act, that serves as an advisor to the Mentor family of mutual funds and to other institutional organizations and high net worth individuals. MIG will be 79.8% owned by the Bank with the remaining 20.2% owned by EVEREN Capital, Inc., an unaffiliated investment advisor.

2. Mentor Investment Advisors, L.L.C. (MIA)

MIA is a Virginia LLC, registered under the 1940 Act, that serves as an advisor to the Mentor family of mutual funds (principally domestic funds) and to other institutional organizations and high net worth individuals. MIA will be 99% owned by MIG with the remaining 1% held by the Bank.

3. Mentor Distributors, L.L.C. (MD)

MD is a Virginia LLC that will be 99% owned by MIG and 1% owned by the Bank. MD currently acts as a distributor of interests in open-end investment companies and provides administrative and back office support. After the First Union/WFBS merger, MD will cease engaging in distribution activities and will arrange for a third-party to serve as a distributor for these investment companies. MD will continue to provide administrative and back office support to that third party distributor.

4. Asset Securitization, Inc. (ASI), JST, L.L.C. (JST), and Financial Asset Securitization, Inc. (FASI)

ASI is a Virginia corporation and will be a wholly-owned subsidiary of the Bank. The sole asset of ASI is its membership interest in JST. The sole asset of JST, in turn, is all of the

issued and outstanding capital stock of FASI. FASI has filed a shelf registration statement with the Securities and Exchange Commission for the issuance of mortgage-backed securities. This registration may be used, from time to time, in connection with securitizations of residential mortgage loans originated or purchased by First Union or its affiliates.

5. Wheat Benefit Services, L.L.C. (Wheat Benefit)

Wheat Benefit is a Virginia LLC engaged in benefit plan design, consulting, recordkeeping and administrative services to various pension and retirement plans. Following the merger, Wheat Benefit will be 51% owned by the Bank and 49% owned by three individuals. The Bank anticipates it may ultimately own 100% of Wheat Benefit.

6. Mentor Trust Company (PA Trust Company) and Mentor Trust Company, Virginia (VA Trust Company)

The PA Trust Company and VA Trust Company (Trust Companies) are each state chartered nondepository trust companies that provide trust services to brokerage and advisory clients of WFBS affiliates. Following the merger, the Bank plans to own the Trust Companies as direct subsidiaries with the Bank having a 100% ownership interest in the PA Trust Company and a 99% ownership interest in the VA Trust Company. The remaining less than 1% interest in the VA Trust Company would be owned by individuals who are currently employees of WFBS or its affiliates. The Trust Companies currently provide trust services to brokerage and advisory clients of WFBS affiliates.

B. Proposed Non-Controlling Interest

1. Mentor Perpetual Advisors, L.L.C. (MPA)

MPA is a Virginia LLC, registered under the 1940 Act, that serves as an advisor to the Mentor family of mutual funds (principally global funds) and to other institutional organizations and high net worth individuals. In total, MPA and MIA advise over 20 mutual funds with a variety of investment strategies and have approximately $11.5 billion in assets under management. MPA will be 50% owned by MIG and 50% owned by Perpetual US, Inc. (Perpetual), a wholly-owned subsidiary of Perpetual, plc, a British entity. Perpetual is not affiliated with the Bank.

The Bank seeks to acquire MPA as part of a broader corporate strategy for the Bank to enhance their proprietary mutual fund family, the Evergreen Funds, and to expand their fund advisory business. Through its investment in MPA, the Bank anticipates gaining expertise in advising global mutual funds which will enhance the investment options in the Bank's and First Union's mutual fund family.

II. ANALYSIS

A. Subsidiaries Engaging in Activities for which the Bank has Previously Received OCC Approval

The Bank requests OCC concurrence that its proposed acquisition of six direct and indirect operating subsidiaries does not require notice or application under section 5.34 because these entities will engage in activities previously approved for a Bank operating subsidiary and the Bank will own over 50%of each entity.

Section 5.34 of the OCC's regulations, 12 C.F.R. § 5.34, sets forth the procedures for banks that seek to establish or commence new activities in an operating subsidiary. As detailed at 12 C.F.R. § 5.34(e)(4), no application or notice is required for adequately or well capitalized banks that intend to establish a new subsidiary where: (1) the new operating subsidiary will be limited to activities previously reported by the bank in connection with the establishment or acquisition of a prior operating subsidiary; (2) the establishment or acquisition of the prior operating subsidiary was deemed permissible by the OCC; (3) the activities in which the new subsidiary will engage continue to be deemed legally permissible by the OCC; and (4) the activities of the new subsidiary will be conducted in accordance with any conditions imposed by the OCC in approving the conduct of these activities for a prior operating subsidiary of the bank.

The Bank's proposed acquisitions of MIG, MIG's subsidiary MIA, and MIG's subsidiary MD from WFBS do not require notice or application under Part 5 because the Bank will own, either directly or indirectly, over 50% of these subsidiaries and these subsidiaries will engage in investment advisory, administrative, and back office services, activities for which OCC has previously granted the Bank operating subsidiary authority. *See* OCC Interpretive Letter No. 804 (September 30, 1997) ("Back-end Fee Letter"), authorizing a bank or a subsidiary to provide retail sales commissions earned on mutual fund sales directly to a selling broker and authorizing a bank or a subsidiary to receive 12b-1 and contingent deferred sales charge fees); OCC Conditional Approval No. 143, (April 15, 1994) (Lieber Letter), authorizing the Bank's acquisition of subsidiaries (Evergreen Asset Management Corp., Lieber & Company, and Keystone Investment Management Company, Inc.) engaged in these activities.

The Bank's proposed acquisitions of ASI, JST, and FASI also do not require notice or application under Part 5 because these proposed operating subsidiaries will engage in mortgage securitization activities, an activity for which the Bank has previously received operating subsidiary authority. *See* OCC Letter to the Bank dated November 21, 1990, which authorized the Bank's acquisition of First Union Commercial Mortgage Securities Corporation (FUCMSC). FUCMSC engages in mortgage securitization activities for Bank and Bank affiliate mortgage assets, as well as mortgage loans originated by unaffiliated commercial banks.

B. Subsidiaries Engaging in Activities for which the Bank has Not Previously Received OCC Approval

The Bank has submitted applications, pursuant to 12 C.F.R. § 5.34, to acquire three additional WFBS entities which will be owned by the Bank as direct and indirect operating subsidiaries. These entities (the Trust Companies and Wheat Benefit) are engaged in activities that the Bank has not previously received authority from the OCC to conduct in an operating subsidiary.[1] The OCC, however, has authorized other national banks to engage in such activities through operating subsidiaries. The activities proposed for the three proposed operating subsidiaries of the Bank also qualify for the OCC's "expedited review" operating subsidiary procedures set forth at 12 C.F.R. § 5.34(e)(3). For each of the proposed operating subsidiaries described below, we approve the Bank's application to acquire these subsidiaries.

1. Wheat Benefit

The Bank has filed an operating subsidiary application to acquire Wheat Benefit which will conduct benefit plan and pension and retirement plan services. The OCC has found national banks may provide these plan services under their fiduciary powers (12 U.S.C. § 92a) and their authority to engage in activities incidental to the business of banking (12 U.S.C. § 24(Seventh)). *See* OCC Corporate Decision No. 96-44 (August 8, 1996) (CoreStates Letter) (permissible for national bank to retain and operate as an operating subsidiary a state chartered bank and trust company which limits its activities to certain specialized fiduciary and closely related services to a limited number of personal trust customers); OCC Interpretive Letter No. 424 *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,648 (April 12, 1988) (American National Letter) (permissible for a national bank with trust powers to provide investment advisory and management services, administrative and back office support through an operating subsidiary). Based upon these precedents, and the Bank's description of Wheat Benefit's activities, we approve the Bank's request to acquire Wheat Benefit as an operating subsidiary.

2. Trust Companies

The Bank has applied to acquire two state-chartered nondepository trust companies as direct operating subsidiaries of the Bank. The Bank has previously received authority to own Keystone Trust Company, a nondepository state-chartered trust company as an indirect operating subsidiary. Keystone Trust is wholly owned by Keystone Investments, Inc., a Bank operating subsidiary. *See* Keystone Letter. But for the distinction between the direct and

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[1] The Bank previously has received OCC approval to own Keystone Trust Company, Portsmouth, New Hampshire, a nondepository state-chartered trust company, as an indirect operating subsidiary. See Multinational Banking letter to the Bank dated November 22, 1996 (Keystone Letter). The Bank's pending application to acquire the Trust Companies would result in the Bank owning each of the Trust Companies as direct operating subsidiaries.

indirect ownership of the subsidiaries, the proposed activities of the Trust Companies and Keystone Trust are identical.

In addition to the approval provided to the Bank by the Keystone Letter, the OCC has previously authorized national banks to own state-chartered nondepository trust companies as subsidiaries pursuant to a national bank's authority to engage in activities incidental to the business of banking under 12 U.S.C. § 24(Seventh). *See* CoreStates Letter, *supra* and American National Letter, *supra*. Accordingly, we approve the Bank's request to acquire PA Trust Company and VA Trust Company as operating subsidiaries of the Bank.

C. Proposed Retention by a Future Bank Operating Subsidiary of a Non-Controlling Interest in MPA.

The Bank's application for MIG (one of the WFBS subsidiaries to be acquired by the Bank as part of the First Union/WFBS transaction) to retain a non-controlling interest in MPA will be considered pursuant to OCC precedent authorizing national banks to acquire indirectly, through operating subsidiaries, non-controlling interests in an LLC. Under the Bank's proposal, MIG will own 50% of MPA and an unaffiliated entity will own the remaining 50% interest. MPA will be engaged in investment advisory activities that are part of, or incidental to, the business of banking and authorized for national banks.

A number of OCC Interpretive Letters have analyzed the authority of national banks, either directly or indirectly through a subsidiary, to own a non-controlling interest in an enterprise. *See, e.g.*, Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81-049 (May 10, 1996). *See e.g.*, Interpretive Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81-012 (November 15, 1995) (national bank's operating subsidiary to hold 25 percent interest and serve as general partner in a partnership to own a trust company).

These letters concluded that ownership of a non-controlling interest in an enterprise is permissible provided four standards, drawn from OCC precedents, are satisfied.[2] They 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. (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.

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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.

Each of these factors is discussed below and applied to your proposal.

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.*

OCC precedents on non-controlling 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, *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); Interpretive Letter No. 645, *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,554 (April 29, 1994) (national bank can take a controlling interest in a LLC to originate and service residential real estate mortgage loans); Interpretive Letter No. 423, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,647 (April 11, 1988) (national bank operating subsidiary authorized to act as managing general partner of a limited partnership investing in real estate mortgage-related assets); Interpretive Letter No. 668, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,616 (October 14, 1994) (national bank permitted 50 percent ownership of LLC which acquires and services mortgage loans); Interpretive Letter No. 694 *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-009 (December 13, 1995) (national bank permitted to take non-controlling, minority interest in a LLC that purchases secured home improvement loans and resells them in the secondary market); Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23, 1996) (national bank authorized to take minority equity interest in mortgage banking company).

MPA will provide investment advisory services to mutual funds, other institutional organizations, and high net worth individuals that are permissible for national banks under 12 U.S.C.§ 24(Seventh). *See*, *e.g.*, 12 C.F.R. § 5.34(e)(3)(ii)(D) which authorizes national banks, under an expedited review process, to establish operating subsidiaries that will serve as investment adviser for investment companies, and 12 C.F.R. §§ 5.34(e)(2)(ii)(C) and (I) which authorize national banks, under a notice process, to establish operating subsidiaries that provide financial advice and consulting for the bank or its affiliates and to act as an investment or financial adviser (not involving the exercise of investment discretion) or provide financial counseling. *See also*, Lieber Letter and OCC Interpretive Letter 648, reprinted in [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557 (May 4, 1994) (authorizing Mellon Bank's acquisition of The Dreyfus Corporation). 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.*

This is an obvious corollary to the first standard. The activities of the enterprise in which the 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. An Amendment to the Operating Agreement (Amendment) entered into by the two investors in MPA (Members) will provide avenues for the Bank to ensure that while it has an investment in MPA, the company's activities will remain permissible.[3] First, the Amendment provides that so long as a national bank has a direct or indirect equity interest in any of the members in MPA, (a) the business and operations of MPA shall be subject to the OCC's supervision and examination; and (b) MPA shall engage solely in activities that are permissible for national banks. The Amendment further provides:

> The Members further agree that, if in the exercise of the National Bank's reasonable judgment, based upon advice of counsel, the National Bank determines that [MPA] is proposing to engage in activities that are impermissible for national banks, then the National Bank, in its capacity as a Member, shall have the right to veto any such proposed activities and otherwise bar [MPA] from allowing such activities to occur.

Second, pursuant to the Operating Agreement entered into by the two Members, a Management Committee consisting of three representatives appointed by each of the Members makes all decisions that could have a material effect on the conduct of the business and other affairs of MPA. Each Member has the authority to remove or replace its representatives to the Management Committee at any time. A majority vote of the Management Committee is generally required for decisions to be made. Accordingly, each of the Members of MPA effectively has veto authority over any significant decision made concerning the activities of the company.

These provisions assure that the Bank, through MIG, will effectively be able to prevent MPA from engaging in any impermissible activity. Thus, the second standard is satisfied.

3. *The bank's loss exposure must be limited 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

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[3] MPA's two Members are MIG and Perpetual plc.

an interest, it is important that a national bank's investment not expose it to unlimited liability.

In the present case, the Bank's risk of loss will be limited by the Virginia LLC Act which provides that a member of a limited liability company shall not have any personal obligation for any liabilities of a limited liability company, whether such liabilities arise in contract, tort or otherwise, solely by reason of being a member, manager, or agent of a limited liability company. Va. Code Ann. § 13.1-1019 (Michie 1993).

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 an entity is to report it as an unconsolidated entity under the equity method of accounting.[4] Under this method, unless the bank has guaranteed any of the liabilities of the entity or has assumed other financial obligations of 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). As proposed, the Bank, through MIG, will have a 50 percent ownership interest in MPA. The Bank will account for its investment in MPA as an unconsolidated subsidiary under the equity method of accounting.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure should be limited to the amount of its investment by statute and any constituent documents and agreements executed by the parties. 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 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 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). The provision in 12 U.S.C. § 24(Seventh) relating to the

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[4] *See* Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995) which details the appropriate accounting treatment for a bank's minority ownership share or investment in an LLC.

purchase of stock, derived from section 16 of the Glass-Steagall Act, was intended to make it clear that section 16 did not authorize speculative investment banking activities in connection with 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 the bank in conducting *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.*, Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991) (national bank authorized to acquire nominal stockholding for membership in corporation of primary dealers in government securities); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988) (national bank permitted to buy Farmer Mac stock in nominal amounts); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed, Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988) (national bank permitted to invest in the Government Securities Clearing Corporation).

This requirement is met here. As noted above, the Bank will use its indirect investment in MPA to enhance the Bank's proprietary mutual fund family. The growth of the Bank's fund advisory business is a priority for both the Bank and First Union and the acquisition of MPA, along with MIG and MIA, will significantly expand the Bank's investment advisory activities. In particular, through its investment in MPA, the Bank anticipates gaining expertise in advising global mutual funds which will enhance the investment options in the Bank's and First Union's mutual fund family.

For these reasons, the Bank's investment in MPA, through MIG, 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

The OCC concurs with your analysis that no notification is required for the Bank to acquire MIG, MIA, MD, ASI, JST, and FASI because the OCC has previously approved Bank operating subsidiaries engaged in the same activities as these six entities. The OCC approves your application to acquire Wheat Benefit, PA Trust Company and VA Trust Company as operating subsidiaries, pursuant to 12 C.F.R. § 5.34, based upon the OCC's previous authorizations to other national banks to acquire operating subsidiaries to engage in these activities. Finally, on the basis of the representations specified in your Letter and its attachments, the OCC finds that the Bank may, through its proposed operating subsidiary, MIG, indirectly hold a non-controlling (i.e., 50 percent) interest in MPA, and the notification is approved subject to the following conditions:

(1) MPA will engage only in activities that are part of, or incidental to, the business of banking;

(2) The Bank, through MIG, will have effective veto power over any activities and major decisions of MPA that are inconsistent with condition number one, or will withdraw from MPA in the event MPA engages in an activity that is inconsistent with condition number one;

(3) The Bank will account for its investment in MPA under the equity method of accounting; and

(4) MIG and MPA will be subject to OCC supervision, regulation, and examination.

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

Please be advised that all conditions of this approval 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.

If you have any questions, please contact Richard Erb, Licensing Manager, at (202) 874-5060, or Joel Miller, Senior Attorney, Securities and Corporate Practices Division, at (202) 874-5210.

Sincerely,

/s/

Julie L. Williams
Chief Counsel