Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 16, 2004

Conditional Approval #643

July 2004

James S. Keller, Esq.
Chief Regulatory Counsel
PNC Bank, National Association
249 Fifth Avenue
One PNC Plaza, 21st Floor
Pittsburgh, PA 15222-2707

Re: Application by PNC Bank, National Association, Pittsburgh, Pennsylvania, for its operating subsidiary to hold special equity interests in connection with investment management activities
Application Control Number: 2004 - NE - 08 - 0007

Dear Mr. Keller:

This responds to the application filed by PNC Bank, National Association, Pittsburgh, Pennsylvania, (the "Bank"), requesting approval for its operating subsidiary, BlackRock, Inc. and its subsidiaries (BlackRock, Inc. and its subsidiaries are referred to herein collectively as "BlackRock"), to hold for limited periods of time limited interests in certain private investment funds for which it serves as investment manager.[1] The Bank indicates that holding such limited interests is convenient and useful in order for BlackRock to conduct its investment management business. Based upon the representations and commitments made by the Bank, the application is approved subject to the conditions described herein.

A. Background

The Bank is a national bank. BlackRock is registered as an investment advisor under the

[1] Due to a misinterpretation of a previous OCC approval, BlackRock acquired the interest in the funds without the Bank having obtained prior OCC approval. To correct this situation and in order to continue to hold these existing interests, the Bank filed this application. The Bank also seeks prior approval from the OCC for BlackRock to receive the same type of interest in other funds it advises.

Investment Advisers Act of 1940.[2] BlackRock serves as an investment manager and advisor for a number of investment funds organized in the United States (the "Funds").[3] The Funds invest primarily in equity and equity-related securities. The Funds may invest in securities and other financial assets in which a national bank ordinarily is not permitted directly to invest.[4] The Funds are organized as limited liability companies and are taxed as partnerships. Consistent with this tax treatment, all the losses, gains, fees, and expenses are passed through from the Funds to their respective investors.

The Funds' investors are primarily institutional investors and high net worth individuals. As investment manager, BlackRock may receive both a management fee and a fee for performance for each of the Funds. The management fee is typically a percentage of the assets of each Fund. The fee for performance is typically a percentage of the profits of each Fund above a certain hurdle rate.

The Bank represents that it is advantageous to U.S. investors in the Funds if BlackRock's compensation for performance is paid as a share of profits, rather than as a fee. To receive a share of the profits, BlackRock needs to hold an interest in the Funds. This interest would take the form of a special membership interest in the limited liability company that constitutes the Fund. As a special member, BlackRock would not participate in all of the gains and losses of the limited liability company, but only in the gains equal to the performance fee to which BlackRock is entitled as investment manager. We refer to BlackRock's special member interests in the Funds as "Special Interests."

Performance compensation can be a substantial percentage of the Funds' respective returns. The Bank represents that individual investors, trusts, and entities taxed as partnerships that in turn have individual or trust investors, prefer that investment funds structure performance compensation as an allocation to the investment manager's equity account rather than as a fee. Under U.S. tax law, individual investors must report as income their proportionate share of the gross amount of an investment fund's income and gains *before* deducting investment-related fees and expenses paid by the investment fund. The limit placed by the U.S. tax laws on the deductibility of these fees and expenses may preclude high-income individuals from deducting their full proportionate share of the fees and expenses of the investment funds. The Bank represents that if the investment manager is paid in the form of a profit allocation, rather than through a performance fee, the amount so paid is not treated as income to investors who are not recipients of the allocation.

For these reasons, the Bank represents that it is an industry practice for investment advisors and

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[2] 15 U.S.C. §§ 80b-1 - 80b-21.

[3] BlackRock also serves as investment manager for a number of private investment funds organized outside the United States. This letter does not address the permissibility of the Bank's activities with respect to the foreign funds.

[4] BlackRock plans to invest only in funds that invest primarily in securities. Any non-securities investments will be limited to financial investments, and will not include real estate or tangible personal property.

managers of certain types of investment funds to receive performance-related compensation as a profit allocation. The OCC has previously recognized this industry practice with respect to similar private investment funds.[5] The similar funds are structured to provide payments for advisory services as fund allocations rather than as fees to maximize tax efficiency for investors. The Bank represents that if BlackRock is not able to structure its performance-based compensation using an allocation of income and gains to its equity account, the Funds would be significantly disadvantaged in competing for investors' business.

BlackRock's ownership interest in the Funds would be limited. BlackRock does not propose to make any out-of-pocket investments in the Funds and will hold a Special Interest in certain Funds only to enable it to receive its performance-based compensation in the form of a profit allocation as described above. The Bank has represented that under the terms of the instruments governing the Funds and creating the Special Interests, BlackRock will not participate in any losses suffered by the Funds. BlackRock will account for its Special Interest in the Funds under the equity method of accounting. BlackRock's loss exposure from an accounting perspective will be limited to the amount of profit allocation it expects to receive as compensation. The Special Interest would not entitle BlackRock to voting rights. The Bank represents that BlackRock will receive a Special Interest in a Fund only while BlackRock provides investment management services to the Fund. BlackRock will withdraw all profit allocations immediately.[6]

BlackRock will receive a Special Interest in a Fund for which it serves as investment manager only to the extent it is necessary to attract investors into the Fund. BlackRock will hold Special Interests only in investment funds that hold securities and financial instruments, and will not invest in any fund that includes real estate or tangible personal property. BlackRock will hold a Special Interest in a Fund containing bank-ineligible investments only while it serves as an investment manager to the Fund, and only if the terms of the instruments governing the Fund allow BlackRock to sell, redeem or otherwise dispose of its equity allocation if it no longer services the Fund.

B. Analysis

Section 5.34(e) of the OCC's operating subsidiary regulation provides that "a national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority."[7] The OCC has long held that a national bank may provide investment management services as part of the business of banking authorized under

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[5] *See,* Conditional Approval No. 578 (February 27, 2003)("Conditional Approval No. 578") and Interpretive Letter No. 940 (May 24, 2002), *reprinted in* [2001-2002 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,465.

[6] The Bank has indicated that BlackRock will have a standing request for redemption of all equity allocations from each Fund. BlackRock will receive the redemption proceeds on the same business day that a Fund determines the final amount of each allocation. Because BlackRock will in effect withdraw all profit allocations immediately, the amount of BlackRock's interest in any Fund as a practical matter would, consistent with Interpretive Letter No. 897, *supra*, never exceed 24.99 percent of the total equity of any fund.

[7] 12 C.F.R. § 5.34(e)(1).

12 U.S.C. § 24(Seventh) and pursuant to their fiduciary powers under 12 U.S.C. § 92a.[8] BlackRock currently engages in the authorized activities of acting as an investment advisor to investment companies and receiving compensation for such services. Holding the Special Interests is an alternative means to receive payment of incentive compensation for advisory services, and is therefore incidental to permissible investment advisory activities.

The authority of an operating subsidiary of a national bank to hold Special Interests in advised funds, subject to certain conditions, was confirmed by the OCC in Conditional Approval No. 578. In that approval, the OCC permitted an operating subsidiary to own similar special interests in investment funds the operating subsidiary managed, reasoning that such ownership is directly related to, and an integral part of, the subsidiary's activity of providing bank-permissible investment management and administrative services to certain private investment funds.[9] The purpose of holding the Special Interests was to enable the operating subsidiary to act as an investment manager to the types of investment funds in which this form of ownership by the investment manager is convenient and useful—indeed necessary. The Special Interests in the investment funds were not to be passive or speculative investments on the operating subsidiary's part. The investments were made solely to enable the operating subsidiary to provide investment management services as conducted by its competitors in the investment management industry. The OCC found that, as a practical matter, in order to offer the funds it manages, the operating subsidiary must structure its compensation to hold the investments in this limited manner. Among other conditions, the OCC required that the Special Interests may be held under these circumstances only when, and for so long as, the operating subsidiary is providing investment management services.

In the instant proposal, consistent with the OCC's determination in Conditional Approval No. 578, BlackRock's ownership of the Special Interests in the Funds it advises will be restricted to a context where the holding is integral to facilitating a recognized bank-permissible activity and therefore such holdings are permissible as an incident to the bank-permissible investment management activities. The Bank represents that BlackRock receiving the Special Interests enables BlackRock to engage in permissible banking activities and act as investment manager for investment funds that, in practice, require the manager to take an equity interest. The Bank further represents that institutional and sophisticated individual investors in these funds require the manager to structure the payment of performance fees in this fashion. In this connection, the Bank states that these investments permit BlackRock to offer funds that provide investors with a tax treatment comparable to that of investors in other, similar funds. The Bank represents that

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[8] *See*, *e.g.,* Interpretive Letter No. 897 (October 23, 2000) *reprinted in* [2000-2001 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-416; Interpretive Letter No. 851 (December 8, 1999) *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,308; Interpretive Letter No. 871 (October 14, 1999) *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,365; Conditional Approval Letter No. 164 (December 9, 1994); Interpretive Letter No. 648 (May 4, 1994) *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; Interpretive Letter No. 647 (April 15, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,558; Interpretive Letter No. 622 (April 9, 1993) *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557; and Interpretive Letter No. 403 (December 9, 1987), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,627.

[9] The OCC also concluded that holding the Special Interests is not prohibited by 12 U.S.C. § 24(Seventh).

BlackRock would be unable to offer these funds on a competitive basis unless BlackRock makes these investments.

Accordingly, BlackRock holding the Special Interests as described by the Bank is permissible subject to the conditions in this letter. As indicated above, the Bank has the authority to conduct in BlackRock activities that the Bank could engage in directly. The investment management services provided by BlackRock are part of the business of banking as authorized under 12 U.S.C. §§ 24(Seventh) and 92a. Holding the Special Interests is an integral component of these investment management services provided by BlackRock. The OCC previously has found that, as a practical matter, in order to offer certain types of funds, national banks and their operating subsidiaries must structure their compensation in this way.[10] Thus, consistent with OCC precedents for both national banks and their operating subsidiaries, holding the Special Interests is a proper incident to these bank-permissible investment management activities.[11]

C. Conclusion

Based upon a review of the information you provided, including the representations and commitments made in your letter, and for the reasons discussed above, we conclude that BlackRock may receive the Special Interests in the Funds, subject to the following conditions:

(1) The Funds shall constitute "affiliates" of BlackRock and the Bank for purposes of Sections 23A and 23B of the Federal Reserve Act.

(2) In connection with BlackRock receiving the Special Interest in the Funds, the Bank shall adopt and implement an appropriate risk management process, acceptable to the OCC Examiner-in-Charge, to monitor these interests. The risk management process shall be comprehensive and shall include:

(i) Adoption and implementation of a conflict of interest policy addressing all inherent conflicts associated with BlackRock's holding of the Special Interests in the Funds; and

(ii) Adoption and implementation of risk management policies and procedures for monitoring the Special Interests in the Funds and the risks associated with those interests, taking into account relevant factors noted in OCC guidance (e.g., OCC Banking Circular 277 (BC-277 - October 1993), Supplemental Guidance 1 to BC-277 (January 1999) and the Handbook for National Bank Examiners, Risk Management of Financial Derivatives (January 1997)).

The Bank shall provide the OCC with copies of the policies and procedures described in (i) and (ii) prior to BlackRock receiving a Special Interest in any new Fund.

(3) Consistent with the conditions in this letter, the Bank, through BlackRock, shall not

[10] *See,* Conditional Approval No. 578 and Interpretive Letter No. 940, *supra*.

[11] *Id.*

receive Special Interests in the Funds other than Funds that invest in securities and financial instruments, and shall not invest in any Fund that holds real estate or tangible personal property.

(4) The Bank shall make reports and other information readily available to OCC supervisory staff as necessary for the OCC to determine compliance with these conditions.

(5) The Bank shall account for BlackRock's Special Interests in the Funds under the equity method of accounting.

(6) The Bank, through BlackRock, shall hold Special Interests in a Fund only when, and only for so long as, BlackRock is providing investment management services to the Fund.

(7) The Bank shall provide its Examiner-in-Charge ten days notice before BlackRock receives Special Interests in any Funds in addition to those in which it already holds an interest as described in footnote 1 above.

Please be advised that the above conditions of this approval shall be 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(b)(1).

This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory and examination authorities under applicable laws and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

Sincerely,

/s/ *Julie L. Williams*

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel