Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #909
May 2001
12 USC 24(7)

May 02, 2001

Dear **[ ]**:

This is in response to your communications of November 24, 2000, and February 6, 2001, concerning a non-controlling equity interest held by **[ ]**, **[** *City*, *State* **]** ("Bank"), in **[ ]** (" "). **[ ]**is an **[** *State* **]** corporation that plans to provide employee benefit services and payroll services to small community banks and their small business customers. The Bank is currently a non-controlling investor in **[ ]**. This letter confirms that, for the reasons set forth below, it is my opinion that upon the commencement of **[ ]**'s proposed activities, the Bank may continue to hold its non-controlling equity investment in **[ ]**, in the manner and as described herein.

A. Background

The Bank currently holds about a two percent interest in the ownership of **[ ]**.[1] The Bank first acquired its interest in **[ ]** in October, 1999. **[ ]** plans to provide employee benefit services and payroll services to small community banks and their small business customers. The Bank represents that small businesses with fewer than 10 employees cannot provide employee benefit services cost effectively due to the overhead costs associated with providing these services. The Bank asserts that its ownership interest in **[ ]** will enable the Bank to provide its small business customers with cost effective ways to provide their employees with benefit services.

[1] This investment is equal to approximately 1.6 percent of the Bank's tier 1 capital.

B. Analysis

A national bank may engage in activities that are part of or incidental to the business of banking. 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.[2] The OCC has concluded that national banks are legally permitted to make a non-controlling investment in a company provided four criteria or standards are met.[3] 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 enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking (or otherwise authorized for a national bank).
>
> (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.

We conclude, as discussed below, that the Bank's investment in **[ ]** will satisfy these four criteria.

> *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 (or otherwise authorized for a national bank).*

The National Bank Act, in relevant part, provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . .

---

[2] *See, e.g.*, Conditional Approval Letter No. 219 (July, 15, 1996).

[3] *See* Interpretive Letter No. 692 (November 1, 1995); Interpretive Letter No. 694 (December 13, 1995).

The Supreme Court has held that this powers clause of 12 U.S.C. ' 24(Seventh) is a broad grant of power to engage in the business of banking, which is not limited to the five enumerated powers. Further, national banks are authorized to engage in an activity if it is incidental to the performance of the enumerated powers in section 24(Seventh) *or* if it is incidental to the performance of an activity that is part of the business of banking.[4]

You have indicated that **[ ]** will engage in the provision of employee benefit services (including purchasing for the customers' employees health, life, and retirement related benefits) and payroll services to small community banks and their small business customers. The OCC has already found that the activities in which **[ ]** plans to engage are permissible for national banks.[5] Thus, the first 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. It is not sufficient that the entity's activities are permissible at the time a bank initially acquires its interest; they must also remain permissible for as long as the bank retains an ownership interest.

The Bank has the ability and the intention to divest itself of its investment in **[ ]** should **[ ]** engage in activities that are impermissible for a national bank. This ability to divest and intention to do so, if necessary, appear adequate to permit the Bank to withdraw its investment in **[ ]** should **[ ]** undertake impermissible activities.

Accordingly, 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

---

[4] *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 215 (1995).

[5] *See, e.g.*, Corporate Decision No. 98-51 (November 30, 1998)(providing employee benefit and compensation advisory services); Conditional Approval Letter No. 270 (February 21, 1998)(providing medical insurance cost information, benefits counseling, premium collection and disbursement, and related activities); Corporate Decision No. 98-13 (February 9, 1998)(providing benefit plan and pension and retirement plan services); 12 C.F.R. §§ 5.34(e)(5)(v)(H)(providing data processing, data warehousing and data transmission products and services), 5.34(e)(5)(v)(J)(providing tax planning and preparation services), 5.34(e)(5)(v)(P)(providing permissible types of insurance agency or brokerage activities).

liability. Normally, this is not a concern when a national bank invests in a corporation, for it is generally accepted that a corporation is an entity distinct from its shareholders, with its own separate rights and liabilities, provided proper corporate separateness is maintained.[6] This is the case here. The corporate veil of **[ ]** will protect the Bank from liability or loss associated with its ownership interests in **[ ]**.[7]

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 less than 20 percent ownership share or investment in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of accounting. You have represented that the Bank will account for its ownership interest in **[ ]** according to the cost method of accounting. Under the cost method of accounting, losses recognized by the investor will not exceed the amount of the investment (including extensions of credit or guarantees, if any) shown on the investor's books.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure arising from its investment in **[ ]** should be limited to the amount of those investments. 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."[8] 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.[9]

In this instance, the ownership interest by the Bank in **[ ]** is not merely evidence of a passive relationship, but rather is part of a business plan between the Bank and **[ ]** to provide useful services to the Bank's small business customers and to their employees. **[ ]**

---

[6] 1 W. Fletcher, Cyclopedia of the Law of Private Corporations § 25 (rev. perm. ed. 1990).

[7] Del. Code Ann. tit. 8, § 102(b)(6) (Michie 1991).

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

[9] *See, e.g.*, Interpretive Letter No. 543 (February 13, 1991); Interpretive Letter No. 427 (May 9, 1988); Interpretive Letter No. 421 (March 14, 1988).

would provide the Bank's small business customers with convenient employee benefit and payroll services that would not be cost efficient for those customers to attempt to provide themselves. Small business customers of the Bank will thus be benefited by being able to purchase a wider range of services from a single and convenient source, without having to incur the expense of developing these services themselves. Thus, the investment is not a mere passive investment unrelated to the Banks' banking business.

Accordingly, the fourth standard is satisfied.

C. Conclusion

Based upon a thorough review of the information you provided, including the representations and commitments made in your letters, and for the reasons discussed above, it is my opinion that upon the commencement of **[ ]**'s proposed activities, that the Bank may continue to hold its non-controlling equity investment in **[ ]**, subject to the following conditions:

(1) **[ ]** will engage only in activities that are permissible for a national bank;

(2) In the event that **[ ]** engages in an activity that is inconsistent with condition number one, the Bank will divest its interest in **[ ]** in accord with the Bank's letter of February 6, 2001;

(3) The Bank will account for its investment in **[ ]** under the equity or cost method of accounting; and

(4) **[ ]** will be subject to OCC supervision and examination, subject to the limitations and requirements of 12 U.S.C. §§ 1820a and 1831v.[10]

These conditions are conditions imposed in writing by the OCC in connection with this opinion letter stating that the Bank's investment in **[ ]** is permissible under 12 U.S.C. § 24 (Seventh). As such, these conditions may be enforced in proceedings under applicable law.

If you have any questions, please contact Senior Attorney John Soboeiro in the Bank Activities and Structure Division, at 202-874-5300.

Sincerely,

-signed-

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[10] This examination authority will be in addition to any authority over KIMG vested in the OCC by the Bank Service Company Act. 12 U.S.C. § 1867(c).