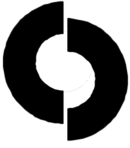

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #254
September 1997

August 21, 1997

Mr. Jeffrey A. Watiker
Vice President Legal Affairs
Citibank, N.A.
425 Park Avenue
New York, NY 10043

Re: Application of Citibank, N.A., New York, New York ("the Bank") to Establish an Operating Subsidiary to Invest in and Become a Member of MECA Software, L.L.C.
Application Control Number 97-ML-08-0016

Dear Mr. Watiker:

This is in response to your operating subsidiary notice ("Notice") submitted pursuant to 12 C.F.R. § 5.34(e)(1) to establish an operating subsidiary to invest in and become a member of MECA Software, L.L.C., ("the LLC" or "MECA"). MECA is a Delaware limited liability company that provides home banking and financial management services through the development, production, marketing, and distribution of computer software and related services. For the reasons discussed below, we approve, subject to certain conditions, the establishment of such operating subsidiary by the Bank because we find that the proposed investment by the operating subsidiary in the LLC would be permissible for national banks under 12 U.S.C. § 24(Seventh).

Background

As described in the Bank's Notice, the Bank intends to establish an operating subsidiary, Citibank Strategic Technology, Inc. ("CSTI"), as a vehicle to invest in and become a member of the LLC.[1] The LLC's primary activities include: designing, marketing and supporting

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[1] CSTI will be incorporated in Delaware as a wholly-owned subsidiary of Citibank. CSTI will be managed by a board of directors, each of whom is expected to be an employee of the Bank or one of its affiliates. CSTI's officers would consist of a President and a number of other executive officers, each of whom is also expected to be an employee of the Bank.

personal computer-based personal financial management and remote financial and insurance software for banks, other financial institution, insurance companies and other entities; and assisting such entities in the marketing of value-added electronic financial and insurance services to customers. The OCC previously authorized other national banks to become members of MECA by direct investment, and determined that MECA's activities are permissible joint venture activities for national banks. *See* Interpretive Letter No. 677, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995).[2] MECA has since developed software products for Internet use, including products derived from its principal software product Managing Your Money. MECA's distribution strategy is now focused on selling products through financial institutions rather than selling products through retail channels. MECA is expected to continue to provide products and services indirectly to consumers through their banks, other financial institutions, networks and bank card associations, and directly through retail distribution to consumers, both individual and small business. Citibank might provide MECA's software and home banking services directly to Citibank's customers (or to the customers of its affiliates), in which case Citibank expects that it would provide the products and services in large part (though not necessarily exclusively) in the principal geographic areas served by Citibank and its affiliates, including the states of California, Connecticut, Florida, Illinois, Maryland, Nevada, New Jersey and New York and the District of Columbia.

MECA's governing documents specifically state that: the LLC will engage only in activities which are legally permissible for national banks; national bank members of the LLC will have authority to veto or withdraw from the LLC in the event that MECA engages in activities otherwise impermissible for national banks; and members of LLC are not liable for the debts, obligations or liabilities of the other members. The LLC's Operating Agreement ("the LLC Agreement") authorizes two membership classes -- Class A and Class B -- but Class B Members will not be entitled to vote or consent with respect to any action taken by the Class A Members. In general, actions of the members would require the affirmative vote or consent of at least a majority of the Class A Members. The Members would manage the business and affairs of the LLC through a Board of Managers. Each Class A Member would be entitled to designate one Manager. In addition, Class A Members could, by unanimous vote, designate two outside managers. The President of MECA would be a Manager and, if the aggregate "percentage interests" of all Class B Members equals or exceeds the "percentage interest" of any Class A Member, then one Manager could be designated by the Class B Members. Currently, there are six Class A Members of MECA and no Class B Members.[3] In its Notice,

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[2] The letter stated that, "[i]t is expected that in the future a limited number of other banks and technology companies will become members of the LLC." Interpretive Letter No. 677 at 1.

[3] It is expected that in the future there could be a limited number of additional Class A and Class B Members.

the Bank seeks to be, at its discretion, either a Class B Member or Class A Member of MECA.[4]

The Bank has signed a letter of agreement with MECA that specifies that the Bank will, subject to OCC approval, pay MECA $3 million for a Class B membership. In addition, the LLC Agreement would give Citibank a right to convert its Class B membership to a Class A membership by making an additional capital contribution of $7.8 million to the LLC.[5] This conversion right would lapse after approximately one year from the date of the Bank's initial $3 million investment. Citibank expects to capitalize CSTI through capital contributions, including a cash contribution of approximately $3 million that will be used to purchase the Class B membership in MECA. If Citibank elects to switch its membership status from Class B to Class A, then an additional cash contribution of approximately $7.8 million would be required.

B. *Discussion*

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). Your application raises the issue of the authority of a national bank to make indirectly, through an operating subsidiary, a non-controlling investment in a limited liability company.[6] In a variety of circumstances the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a minority interest in an enterprise. The enterprise might be a limited partnership, a corporation, or in more recent examples, a limited liability company. The OCC has concluded that national banks are legally permitted to make a minority

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[4] If MECA continues to have six Class A Members and each of their total capital contributions remain unchanged and Citibank becomes a Class B Member that has contributed $3 million to MECA, then the Bank's "percentage interest" in MECA would be 4 percent and each Class A Member's percentage interest would be 16 percent. If Citibank chooses to become a Class A Member by making an additional capital contribution of $7.8 million to MECA, the Bank's "percentage interest" in MECA would increase from 4 to 14.28 percent, and the "percentage interest" of each of the other Class A Members would decrease from 16 to 14.28 percent.

[5] If Citibank converts its membership in MECA from Class B to Class A, then it would be entitled to designate one Manager and could participate in any votes by the Class A Members regarding the designation of the outside Mangers.

[6] The OCC has previously approved indirect investments by national banks in limited liability companies through an operating subsidiary structure. *See, e.g.,* OCC Conditional Approval Letter No. 219 (July 19, 1996). Such investments are permissible if they meet the requirements for direct minority investments by national banks.

investment in an LLC provided four criteria or standards are met. *See* OCC Interpretive Letter No. 692, *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995) and OCC Interpretive Letter No. 694, *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995). These standards, which have been distilled from our previous decisions in the area of permissible minority 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. (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 proposed indirect investment by the Bank in MECA satisfies 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.*

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…

12 U.S.C. § 24(Seventh).

The Supreme Court has held that the powers clause of 12 U.S.C. § 24(Seventh) is a broad grant of power to engage in the business of banking, including, but not limited to the enumerated powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.,* 115 S.Ct. 810 (1995) ("VALIC").

It is well established that a national bank may use electronic means to perform services expressly or incidentally authorized to national banks. *See* OCC Interpretive Letter No. 677, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995);OCC Interpretive Letter No. 284, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,448 (March 26, 1984); and OCC Interpretive Letter No. 449, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,673 (August 23, 1988). As noted in the recently revised OCC Interpretive Ruling recognizing this authority, a national bank may "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide or deliver." *See* 12 C.F.R. § 7.1019 (1996).

Interpretive Letter No. 677 recognized that MECA's activities are permissible for national banks to engage in directly; thus, they are permissible for an operating subsidiary of a national bank. In addition, as discussed in the *Background* section, *supra*, the LLC Agreement provides that MECA will engage only in activities that are legally permissible for national banks, and national bank members of MECA have authority to veto or withdraw from the LLC in the event the LLC engages in activities otherwise impermissible for national banks. 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.*

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 initially purchases stock, but for as long as the bank has an ownership interest.

The LLC Agreement and the Letter of Agreement Citibank has signed with MECA contains certain safeguards to ensure that this standard is met. The LLC Agreement provides that the LLC will only engage in activities for national banks. Article II, section 2.8(b). In addition, national bank members have authority to veto or withdraw from the LLC in the event that MECA engages in activities otherwise impermissible for national banks. The LLC Agreement provides:

> Any Member may withdraw from the Company without the consent of the other Members if: (1) such Member reasonably determines on written advice from counsel that the Company is engaged or proposes to engage in activities which are not legally permissible (without necessary approvals, if any, being obtained) for a national bank, bank holding company, an insurance company or a non-bank or non-insurance company subsidiary thereof; (ii) at least sixty (60) days prior to such withdrawal, such Member notified the other Members of the activities which it deems to be impermissible and the reason such activities are believed to be impermissible; and (iii) the Company is continuing to engage or determines to engage in such activities notwithstanding such notice.

Article VIII, section 8.2(a).

Although the Bank, if it decides to become a Class B member, will not have be able to vote on LLC matters, it will still have the opportunity to withdraw from the LLC in the event MECA engages in activities otherwise impermissible for national banks. The Bank has stated that it will withdraw from MECA should the LLC engage in any impermissible activities for national banks. In addition, pursuant to the Letter of Agreement, if Citibank converts its Class B membership to MECA to a Class A membership, then it would be entitled to designate one Manager and could participate in any votes by Class A Members regarding the designation of

the outside Managers. By these means, the Bank will be able to ensure that MECA engages only in activities that are part of, or incidental to, the business of banking.

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 a bank's investment not expose it to unlimited liability. Such is the case here.

As members of a Delaware limited liability company, the liability of the Bank for the debts, obligations or liabilities of the company will be limited under Delaware law to the amount of the Bank's capital investment in the company. The LLC Agreement contain provisions that confirm that no investor in the LLC will have liability for the debts, obligations, and liabilities of MECA. Article III, section 3.1(d).

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 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). Interpretive Letter No. 692, *supra.* Similarly, under the cost method of accounting, the investor records an investment at cost, dividends or distributions from the entity are the basis for recognition of earnings, and losses recognized by the investor are limited to the extent of the investment. In sum, regardless of which accounting method is used, the investing bank's potential loss is limited to the amount of the investment.

As proposed, the Bank will have either a 4 percent or 14.28 percent ownership share in MECA, depending upon whether it becomes a Class B or Class A Member.[7] The Bank has

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[7] A member's "percentage interest" would be determined by a mathematical formula that takes into account the total capital contributions made by such member and whether the

stated that the appropriate accounting treatment for its investment is the cost method. [8] Thus, Citibank's loss from an accounting perspective will be limited to the cost of Citibank's investment and the Bank will not have any open-ended liability for the obligations of MECA.

In addition, as noted above, Delaware law limits members' losses to their capital investment. The LLC Agreement contains provisions that confirm that no investor in MECA will have liability for the debts, obligations, and liabilities of the LLC. Since the Bank will not have open-ended liability for the obligations of 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 convient 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 purchase of stock, derived from section 16 did not authorize speculative investments in stock. *See* Interpretive Letter No 697 (November 15, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,012. 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.,* Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,225 (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)

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member is a account the total capital contributions made by each member and whether the member is a Class A or Class B Member.

[8] OCC's Chief Accountant has concluded that the Bank's investment in the LLC should be recorded as "Investments in unconsolidated subsidiaries and associated companies" on the Bank's Consolidated Reports of Condition and Income ("Call Reports"). Such classification is consistent with the Call Report Instructions. *See* Instructions to Schedule RC-M, item 8.b. Accordingly, any loss that may be realized by the LLC would not pass through to the books of the Bank other than to the extent that the value of the Bank's interest would thereby be reduced, in which case the amount of such loss would be limited to the amount of the Bank's investment in the LLC.

¶ 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. The LLC will be providing services to the investing Bank that will enable the Bank to offer its banking customers a competitive package of home banking and financial services. Citibank is investing in MECA in order to further its banking business. Through its investment in MECA, Citibank will, among other things, be able to participate (and gain important expertise) in the development, design, marketing and support of personal computer-based personal financial management and remote financial software for banks and other entities, including software design for Internet use. Moreover, Citibank might provide MECA's software and home banking services directly to Citibank's customers (or to the customers of its affiliates) which would provide a valuable service to those customers. The Bank's participation in MECA will enable Citibank to provide these services in a more efficient manner -- the costs associated with MECA can be shared with the other joint venturers -- thus permitting Citibank to conduct activities, gain expertise, and service its customers in ways that might well be cost-prohibitive if performed by Citibank alone.

For these reasons, the Bank's investment in MECA, through CSTI, 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.

C. Conclusion

On the basis of the representations specified in your notification letter and other submitted materials, the OCC finds that the Bank may establish an operating subsidiary that will invest in MECA Software, L.L.C. ("the LLC") and that the notification is approved subject to 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 will withdraw from the LLC in the event that the LLC engages in any activities that are inconsistent with condition number one;

(3) The Bank will account for the investment in the LLC under the cost method of accounting; and

(4) The LLC and CSTI 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.

Sincerely,

/s/

Julie L. Williams
Chief Counsel