Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #868
November 1999
12 USC 24(7)

August 16, 1999

Re: **[*Bank*]**

Dear **[ ]**:

This is in response to your letter of January 22, 1999, as supplemented by your letter of July 26, 1999, requesting that that OCC opine that **[*Bank , City, State*]**, ("Bank"), may receive, retain and -- at some future date -- exercise warrants to acquire stock in **[*Co., City , State*]** ("Company"). The Company provides services and technology to facilitate payments over the Internet. As part of an overall enterprise with the Bank, the Company has issued warrants to the Bank to purchase shares of the Company's common stock. For the reasons set out below, we believe that the Bank may receive, retain, and exercise warrants to acquire stock in the Company.[1]

I. Background

A. The Company

The Company is a provider of services and technology enabling secure electronic payments over the Internet. The Company offers electronic analogues of cash, credit and debit cards, and checks to enable businesses and financial institutions to accept payments over the Internet. For example, the Company's card services enable Internet-based merchants to accept credit or debit card transactions from consumers and to transmit those transactions to the merchant's bank or credit card processor for

[1] While the Bank is acquiring warrants, rather than stock in the Company, the Bank has asked that this letter treat the warrants as if they were fully exercised so that there is no need to seek further approval if and when the warrants are exercised.

processing in a secure manner. Similarly, the Company's electronic cash services enable Internet merchants to accept cash-like payments from consumers in a convenient, cost-effective manner.[2]

B. Joint Enterprise

In October 1998, the Bank and the Company entered into an operating agreement ("Operating Agreement") pursuant to which the Bank agreed to license the Company's software that facilitates payment of Internet-based purchases of goods and services. The software, entitled **[ ]** ("Software"), makes on-line shopping easier for consumers by providing one-click shopping at the website of any Internet merchant ("Merchant") that uses the Software. The Software requires a consumer to input pertinent billing and shipping information, including a credit card number, at the time of an initial on-line purchase with a participating Merchant. When that shopper makes a later purchase from any Merchant who uses the Software, the information about the consumer is automatically provided and the consumer may complete the transaction simply by entering a password.

Under the Operating Agreement, the Bank is both providing the Company with a license to use the Bank's trademarks in the Software and marketing the Software to merchants. The Company is providing the Bank a license to use the Software and provides all technical and operating support to the Bank by customizing, installing, operating, and maintaining the Software.[3] In exchange for the Company's services and license, the Bank paid or is paying customization, licensing, and operations fees.[4] The Bank also provides the Company with a royalty on all purchases made over the Internet using the Software and a Bank-issued credit card.

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[2] In connection with the services it provides, the Company may have access to personal customer information. The Company has adopted a statement of policy ("Privacy Policy") concerning the treatment of this information in the conduct of its business that recognizes the customer's expectations for privacy and provides standards for the use of the customer's financial information. Under the Privacy Policy, the Company represents that it will not share individually identifiable information about consumers with third parties except under limited circumstances. This includes where the customer specifically consents, where it is necessary to process transactions and provide services, and where ordered by a duly empowered governmental authority. When the Company makes its technology or services available to business partners, the Company will not share with them any more consumer information than is necessary. The Company will also make every reasonable effort to assure, by contract or otherwise, that its business partners use its technology and services in a manner that is consistent with the Privacy Policy. The Company further represents in its Privacy Policy that it trains all of its employees about the importance of privacy, and gives access to information about consumers only to those employees who require it to perform their job. Access to privacy-sensitive information is further subject to rigorous procedural and technological controls, designed to preclude unauthorized access to or disclosure of customer information.

[3] The OCC has examination and regulation authority over the Company for services performed by contract or otherwise for the Bank or any national bank pursuant to 12 U.S.C. § 1867(c).

[4] Under the Agreement, the combined total of these fees is capped at $3,000,000.

The Bank and the Company also entered into a separate warrant agreement ("Warrant Agreement") in November 1998. As further consideration for the Bank's entry into the Operating Agreement, the Bank received warrants entitling the Bank to purchase shares of the Company's common stock. The warrants became exercisable in full or in part commencing on January 1, 1999, and terminate on September 30, 2003.[5]

II. Analysis

Your letter raises the issue of the authority of a national bank to make a non-controlling, minority investment in an enterprise. In a variety of circumstances the OCC has permitted national banks to own a non-controlling interest in an enterprise.[6] The OCC has concluded that national banks are legally permitted to make a minority investment in a company provided four criteria or standards are met.[7] These standards, which have been distilled from our previous decisions in the area of permissible minority investments for national banks 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 standards, 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 and useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Based upon the facts presented, the Bank's proposal satisfies these four standards.

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*

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[5] Were it to exercise all of the warrants, the Bank would own approximately 12 percent of the Company's outstanding common stock.

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

[7] See OCC Interpretive Letter No. 694, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995); OCC Interpretive Letter No. 692, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995).

The Company is currently engaged in activities that are permissible under 12 U.S.C. § 24(Seventh) as part of, or incidental to, the business of banking. The Company provides software and support services for cash-equivalent transactions, electronic checking services, and secure credit and debit card payment mechanisms. All of the Company's current activities facilitate the electronic transfer of funds from consumers to businesses and financial institutions. These activities relate to various aspects of the payments system that are central to banking.[8]

Moreover, the software programs that the Company provides are permissible to the extent they perform activities commonly undertaken by banks directly for themselves, other financial institutions,[9] or as part of servicing customers,[10] or constitute the underlying software allowing the banks and their customers to perform these financially related services.[11] It is well established that a national bank may use electronic means to perform services expressly or incidentally authorized to national banks.[12] In fact, the OCC Interpretive Ruling setting forth this authority was recently revised to authorize a national bank to "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is authorized to perform, provide, or deliver." 61 Fed. Reg. 4849 (1996), codified at 12 C.F.R. § 7.1019.

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[8] E.g., OCC Conditional Approval Letter No. 289 (October 2, 1998) ("Integrion/CheckFree Letter") (allowing an indirect investment in a company engaged in electronic bill payments, home banking, and other financial activities); OCC Interpretive Letter No. 732, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996) (permitting an investment in a company engaged in electronic funds transfer and electronic data interchange).

[9] National banks can sell software to other banks as a form of correspondent service if the software performs bank-related data processing functions. See OCC Interpretive Letter No. 449, reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,673 (Aug. 29, 1983).

[10] This would include software with banking, tax estimation, financial planning, and investment analysis components, and ancillary services related thereto. See, e.g., OCC Interpretive Letter No. 677, reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (Jun. 28, 1995) (national bank can engage in joint venture to develop and distribute home banking and financial management software and data processing services to be distributed both through the bank and retail outlets). The software consisted essentially of home banking, tax estimation, financial planning, and investment analysis components, and ancillary services related thereto including the furnishing of checks and other financial forms for the use of customers. The OCC found that all of these types of activities or services had been approved for national banks and their subsidiaries and concluded that banks can provide those services to customers whether or not data processing equipment and programs are utilized. See also OCC Interpretive Letter No. 756, reprinted in [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-120 (Nov. 5, 1996) (cash management software).

[11] See, e.g., OCC Conditional Approval No. 221 (Dec. 4, 1996) (national bank can sell software where software will enable bank customer to receive or utilize other services of the bank).

[12] See, e.g., OCC Interpretive Letter No. 677, supra; OCC Interpretive Letter No. 449, supra; OCC Interpretive Letter No. 284, reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,448 (Mar. 26 1984).

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 from 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.

Minority shareholders in a corporation do not possess a veto power over corporate activities as a matter of corporate law. Accordingly, the Bank lacks the ability to restrict the activities of the Company to only bank permissible activities. It has (or will have upon exercise of the warrants) a minority ownership interest and lacks representation on the board of directors. However, the Bank can divest its shares of the Company's stock subject to applicable securities laws. The Bank has represented that it will divest its interest in the Company should the Company engage in any activities that are not permitted for national banks or entities in which national banks may invest. This divestiture option is adequate to meet the second element.[13]

Furthermore, because the basis of the Bank's authority to acquire and hold the warrants is the authority to own the underlying stock, it follows that the Bank must dispose of the warrants in situations which would require it to dispose of the stock.[14] Therefore, the Bank must also dispose of any warrants it is holding if the Company engages in any activities that are not permitted for national banks or entities in which national banks may invest. The Warrant Agreement allows the Bank to transfer the warrants, and the Bank represents that it will do so if the Company engages in impermissible activities.

Therefore, 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. Typically, this is not a concern

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[13] OCC Interpretive Letter No. 852, reprinted in [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-309 (Dec. 11, 1998).

[14] Cf. Integrion/CheckFree Letter, supra.

when a national bank invests in corporations, for shareholders are not liable for the debts of the corporation, provided proper corporate separateness is maintained.[15] This is the case here.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting measure, 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. Under the equity method of accounting, unless the investor has extended a loan to the entity, guaranteed any of its liabilities, or has other financial obligations, the investor's losses are generally limited to the amount of the investment shown on the investor's books. See generally Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock).

The Bank has (or will have upon exercise of the warrants) no greater than a 12 percent ownership interest the Company. The Bank believes, and its accountants have advised, that the appropriate accounting treatment for the Bank's investment is the equity method.[16] Thus the Bank's loss from an accounting perspective would be limited to the amount invested in the Company, and the Bank will not have any open-ended liability for the obligations of the Company.

The Bank's loss exposure is limited, as a legal and accounting matter. Therefore, 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 that is not an operating subsidiary of the bank must also satisfy the requirement that the investment have a beneficial connection to that bank's business, i.e., it must be convenient or useful to the investing bank's business activities and not constitute a mere passive investment unrelated to the 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*

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[15] Cheatle v. Rudd's Swimming Pool Supply Co., 234 Va. 207, 212, 360 S.E.2d 828, 831 (1987) ("The proposition is elementary that a corporation is a legal entity entirely separate and distinct from the shareholders or members who compose it."); 1 W. Fletcher, Cyclopedia of the Law of Private Corporations, § 25 (rev. perm. ed. 1990).

[16] OCC's Chief Accountant has concluded that the Bank's investment 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.

Tours, Inc. v. Camp, 472 F.2d 427, 432 (1st Cir. 1972). Therefore, the investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.[17]

This requirement is met in this case. The Bank's current enterprise with and investment in the Company are the result of a strategic business relationship between the Bank and the Company. The investment will be consistent with the Bank's campaign to provide secure and reliable credit card payment services over the Internet. The Bank's involvement with the Company will foster the Bank's ability to offer customers secured electronic credit card services in a manner consistent with, and supportive of, the Bank's banking activities.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may make a non-controlling, minority investment in the Company, subject to the following conditions:

1. The Company may engage only in activities that are part of, or incidental to, the business of banking;

2. In the event that the Company engages in an activity that is inconsistent with condition number one, the Bank will divest its interest -- whether common stock or warrants -- in the Company;

3. The Bank will account for its investment in the Company under the equity method of accounting; and,

4. The Company will be subject to OCC supervision, regulation, and examination.[18]

Please be advised that all conditions of this approval are "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.

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[17] See, e.g., OCC Interpretive Letter No. 697 (November 15, 1995), reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-012; OCC Interpretive Letter No. 543 (February 13, 1991), reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255; OCC Interpretive Letter No. 427 (May 9, 1988), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651.

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

If you have any questions, please contact Steven Key, Attorney, Bank Activities and Structure at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
Chief Counsel