Comptroller of the Currency
Administrator of National Banks

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Interpretive Letter #831
June 1998
12 U.S.C. 24(7)

June 8, 1998

Gentlemen:

This responds to your letter of April 2, 1998, requesting confirmation that [ ], [*City, State*] ("*Bank1*") may lawfully acquire a minority, noncontrolling interest in [ ] ("*Bank2*"), [C*ity, State*]. For the reasons set forth below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

I. BACKGROUND

The OCC has received an application to charter [*Bank2*], a limited purpose national bank[1] in [*City*]. [*Bank2*] is being organized on behalf of [ ] ("*LLC1*"), an [*State*] limited liability company, and its sole owner, [ ] ("*LLC2*"), also an [*State*] limited liability company. Shortly after the approval of the charter and the organization and capitalization of [*Bank2*], it is proposed that [*LLC1*] will sell 24.9 percent of the outstanding stock of [*Bank2*] to [*Bank1*].[2]

[*Bank2*] is being organized in order to provide trust services primarily in the [*City*] area. [*Bank2*] will limit its activities to the provision of fiduciary services, focusing exclusively on the personal trust business. Such services will include financial and estate planning, management of investments, real estate, and oil and gas properties, and agency and

[1] For purposes of this opinion, the terms "limited purpose national bank" and "limited purpose national trust company" are used interchangeably.

[2] The acquisition will not require [Bank1] to file a notice under the Change in Bank Control Act, since it will be less than 25 percent. *See* 12 U.S.C. § 1817(j)(8).

custody services. Corporate and pension services may be offered in the future. Under the proposed organization plan, [*Bank1*] will have two directors on [*Bank2*]'s five-person board.

II. ANALYSIS

[*Bank1*]'s purchase of a 24.9% interest in [*Bank2*] raises the issue of the authority of a national bank to hold a minority, noncontrolling interest in an enterprise. 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 entity. The entity may take different forms, including a limited partnership, a corporation, or a limited liability company.[3]

These letters have concluded that such minority, noncontrolling investments are legally permitted provided that four criteria or standards are met. 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 bank invests 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; and (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. Each of these standards is discussed below and applied to the proposed investment by [*Bank1*].

> *1. The activities of the enterprise in which the bank invests must be limited to activities that are part of, or incidental to, the business of banking.*

Our precedents on minority stock 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

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[3] *See* Interpretive Letters No. 737, [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-101 (Aug. 19, 1996); No. 732, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996); No. 694, [1995-1996 Transfer binder] Fed Banking L. Rep. (CCH) ¶ 81-009 (Dec. 13, 1995); and No. 692, [1995-1996 Transfer Binder] Fed. Banking L. Rep (CCH) ¶ 81-007 (Nov. 1, 1995). *See also* Interpretive Letter No. 697, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-012 (Nov. 15, 1995) (national bank may indirectly own a 25 percent interest in a state-chartered trust company); and Interpretive Letter No. 815, [Current] Fed. Banking L. Rep. (CCH) ¶ 81-263 (Dec. 2, 1997) (national bank may retain a 15 percent interest in a state-chartered trust company).

to, the business of banking.[4] In the present case, the application represents that [*Bank2*] is being

organized for the limited purpose of providing trust and fiduciary services, including the normal and customary services associated with administering trusts and estates, providing agency and custody services, and serving in various fiduciary capacities. Pension and employee benefit services may be provided in the future. It is well established that national banks may engage in trust activities to the same extent as state-chartered institutions in the same state. 12 U.S.C. § 92a. Banks in [*State*] are permitted to exercise fiduciary powers. [*State Stat. Ann.*]. Moreover, as previously mentioned, the OCC has specifically approved minority investments in trust banks. Interpretive Letter No. 815, *supra*; Interpretive Letter No. 697, *supra*. Thus, the activities to be performed by [*Bank2*] are activities that are part of, or incidental to, the business of banking, and 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. The activities of an enterprise in which a national bank invests must be part of, or incidental to, the business of banking not only at the time the bank initially acquires its ownership, but they must remain so for as long as the bank has an ownership interest. This standard may be met if the bank is able to exercise a veto power over the activities of the enterprise, or is able to dispose of its interest. *See, e.g.*, Interpretive Letter No. 711, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23, 1996); Interpretive Letter No. 692, *supra*. This ensures that the bank will not become involved in activities that are not part of, or incidental to, the business of banking.

The application documents in this case reflect that [*Bank2*] will be engaged in the provision of fiduciary services, which is a permissible activity for national banks. The proposed Articles of Association for [*Bank2*] provide that its business will be limited to the operations of a trust department and related support activities, and that [*Bank2*] will not expand or alter its business beyond the stated activities without the prior approval of the Comptroller of the Currency. Upon its formation, [*Bank2*] will also be prohibited from engaging in activities that are not incidental to the business of banking, under the provisions of 12 U.S.C. § 24(7). Thus, [*Bank2*] will be prevented as a matter of law from engaging in activities that are not a part of, or incidental to, the business of banking.

In addition to these restrictions, the proposed bylaws of [*Bank2*] provide that the directors will have veto power over any activities which they deem unsuitable for the trust company. Also, the purchase of shares by [*Bank1*] is subject to a shareholder's agreement which

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[4] *See, e.g.*, Letter from Robert B. Serino, Deputy Chief Counsel (Nov. 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in such a network is permissible); Interpretive Letter No. 380, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (Dec. 29, 1986) (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services).

provides that [*Bank1*] sell its shares in [*Bank2*], with [*LLC1*] having a right of first refusal. Thus, [*Bank1*] may exercise a veto power over [*Bank2*]'s activities, or dispose of its interest. 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 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 a legal matter, the stockholders of national banks are not, as a general rule, personally liable for the debts and acts of the bank. *See* 9 C.J.S. *Banks and Banking* § 506 (1996); *Williamson v. American Bank*, 115 F. 793 (1902); 12 U.S.C. § 64a. Thus, [*Bank1*]'s loss exposure for the liabilities of [*Bank2*] is limited as a matter of law.

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a minority investment is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has extended a loan to the entity, guaranteed any of its liabilities, or has other financial obligations to the entity, 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); Interpretive Letter No. 692, *supra*.

[*Bank1*] will have a 24.9 percent ownership interest in [*Bank2*], and will account for its investment under the equity method. [*Bank1*]'s loss exposure is limited to the amount of its investment, and is also subject to [*Bank1*]'s right to dispose of its shares by selling its interest to the majority shareholder. You have represented that [*Bank1*] will not make any loans to [*Bank2*], and will not guarantee any of [*Bank2*]'s obligations or be otherwise obligated on any liabilities of [Bank2].

Accordingly, for both legal and accounting purposes, [*Bank1*]'s potential loss exposure relative to [*Bank2*] should be limited to the amount of its investment. That exposure is quantifiable and controllable, and [*Bank1*] will not have open-ended liability for the liabilities of [*Bank2*]. The third standard is therefore 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.

Under 12 U.S.C. § 24(Seventh), a national bank is given all incidental powers that are necessary to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful." *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). 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 the bank's business, *i.e.*, be convenient or useful to the investing bank's business activities, and not be a mere passive investment unrelated to its business activities. OCC precedents concerning stock ownership have consistently indicated that such ownership 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.

In the present case, you have represented that [*Bank1*] has valid business reasons for its investment in [*Bank2*]. You state that [*Bank1*] currently possesses fiduciary powers, but has not actively exercised those powers. The proposed minority investment in [*Bank2*] will afford [*Bank1*] the opportunity to provide a wider scope of trust services to its customers, and also to expand into new trust markets. Thus, the investment is convenient or useful to [*Bank1*], and is not merely passive or speculative. Accordingly, the fourth standard is satisfied.

III. CONCLUSION

Based upon the information and representations you have provided, and for the reasons discussed above, it is our opinion that [*Bank1*] is legally permitted to acquire and hold a non-controlling interest in [*Bank2*] in the manner and as described herein, subject to the following conditions:

1. [*Bank2*] will engage only in activities that are a part of, or incidental to, the business of banking;

2. [*Bank1*] will have veto power over any activities and major decisions of [*Bank2*] that are inconsistent with condition number one, or will withdraw from [*Bank2*] in the event that it engages in an activity that is inconsistent with condition number one;

3. [*Bank1*] will account for the investment in [*Bank2*] under the equity method of accounting; and

4. [*Bank2*] will be subject to OCC supervision, regulation and examination.

These conditions are conditions imposed in writing by the OCC in connection with its action on the request for a legal opinion confirming that [*Bank1*]'s investment is permissible under 12 U.S.C. § 24(Seventh) and, as such, may be enforced in proceedings under applicable law.

If you have any questions, please contact me or Stephen Brown, Senior Attorney, at (214) 720-7012.

Sincerely,

/s/

Randall M. Ryskamp

District Counsel