Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #275
May 1998

April 22, 1998

H. Anderson Ellsworth, Esq.
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Re: National Penn Bank -- Establishment of an Operating Subsidiary to Acquire and Hold a 70% Non-controlling Interest in a Limited Partnership Which Will Engage in Title Insurance Agency Activities.

Application Control Number: 98 NE 08 0005

Dear Mr. Ellsworth:

This is in response to your operating subsidiary application filed on behalf of National Penn Bank, Boyertown, Pennsylvania (the "Bank") pursuant to 12 C.F.R. §5.34. As indicated in that application, the Bank proposes to establish a wholly-owned operating subsidiary (the "Subsidiary") to acquire and hold a 70 percent non-controlling interest in a limited partnership which will engage in the business of selling title insurance as agent. Based on the information and representations provided by the Bank, and for the reasons given below, the application is approved, subject to the conditions set forth herein.

The Bank's Proposal

The Subsidiary proposes to hold a 70 percent non-controlling limited partner interest in a newly formed Pennsylvania limited partnership known as Link Abstract, L.P.(the "Partnership"). Pioneer Agency, an unrelated Pennsylvania limited partnership ("Pioneer"), will be the sole general partner of the Partnership and will hold the remaining 30 percent partnership interest. The Subsidiary will contribute 70 percent and Pioneer will contribute 30 percent of the Partnership's initial capital. It is anticipated that the Subsidiary's initial capital contribution will be approximately $15,000. Profits and losses will be allocated and distributed proportionately between the Subsidiary and Pioneer in accordance with their respective partnership interests.

The Partnership will operate pursuant to a Limited Partnership Agreement entered into between the Subsidiary and Pioneer (the "Agreement").[1] In accordance with the terms of the Agreement, Pioneer, as general partner, will be responsible for the exclusive control and management of the Partnership. The Subsidiary, as the sole limited partner, will have no control or voting rights with respect to the management of the Partnership. Notwithstanding the foregoing, the Subsidiary has the right to prevent the Partnership from engaging in any activity if that activity is not a part of, or incidental to, the business of banking. Furthermore, the Subsidiary has the right to withdraw from the Partnership at any time.

Under the terms of the Agreement, the Subsidiary, as limited partner, shall not be personally liable for any of the debts, obligations or losses of the Partnership beyond its partnership interest. As more fully discussed in the Agreement, separate capital accounts shall be established and maintained for the Subsidiary and Pioneer consisting of the value of each partner's respective contributions to the Partnership's capital. Each partner's capital account shall be adjusted as necessary to reflect (1) its distributive share of Partnership profits and losses according to the partner's relative percentage of Partnership interest; (2) its additional capital contributions; and (3) distributions by the Partnership to such partner. The Agreement further states that, in no event, shall the Subsidiary be liable for any amount beyond the balance in its capital account. In addition, the Subsidiary shall not be required to make any additional capital contributions to the capital of the Partnership except as the general partner and the Subsidiary may by writing agree.

The Partnership will be licensed as a title insurance agency by the Commonwealth of Pennsylvania and all title examiners employed by the Partnership will be licensed by the Commonwealth of Pennsylvania to the extent required by Pennsylvania law. The Partnership will sell, as agent, title insurance. The Partnership will offer and promote title insurance to the general public. At the outset, however, it is anticipated that the Partnership's principal customers will be the Bank and its mortgage, consumer, and commercial lending customers. The Bank represents that all referrals of bank customers to the Partnership will be made in compliance with applicable federal and state law.

The Partnership will have its registered office and principal place of business for state filing and licensing purposes in the Borough of Boyertown, Pennsylvania. The population of the Borough of Boyertown as of the 1990 census was 3,759.[2] All business records of the Partnership will be available at the Boyertown location. All examiners and other personnel of the Partnership will be managed and supervised by Pioneer, as general partner, through the Boyertown location.

Analysis

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[1] An initial draft of the Agreement was submitted with the Bank's application. Certain revisions to the initial draft were received on March 12, 1998. We rely upon bank counsel's representation that the March 12, 1998 revisions will be incorporated into the final document to which the parties will agree.

[2] The Bank's head office is located in, and the Bank has branches in, the Borough of Boyertown, Pennsylvania.

In the present case, although the Subsidiary will own a 70 percent interest in the Partnership, it will do so as a limited partner with, generally, no control over the management of the Partnership.[3] The Bank's application, thus, raises the issue of the authority of a national bank to hold, through an operating subsidiary, a non-controlling interest in an entity, specifically, a limited partnership which will engage in the business of selling title insurance as agent.[4] 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. The enterprise might be a partnership, a corporation, or a limited liability company. *See, e.g.*, Interpretive Letter No. 692, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81,007 (November 1, 1998); Interpretive Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-013 (November 15, 1995); Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996). Our previous decisions have concluded that the ownership of a non-controlling interest is permissible provided four standards are met. They are:

1. The activities of the entity or 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; and

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 entity or 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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[3] As indicated above, the Subsidiary will have the ability to prevent the Partnership from engaging in any activity that is not a part of, or incidental to, the business of banking.

[4] The OCC recently amended its operating subsidiary rule, 12 C.F.R. § 5.34, as part of a general revision of Part 5 under the OCC's Regulation Review Program. Operating subsidiaries in which a national bank may invest include corporations, limited liability companies, or similar entities if the parent owns (1) more than 50 percent of the voting (or similar type of controlling) interest, or (2) less than 50% so long as the bank "controls" the subsidiary and no other party controls more than 50 percent. 12 C.F.R. § 5.34(d)(2). Here, the Partnership will not be considered an operating subsidiary since the Bank will not "control" the Partnership.

Our precedents on non-controlling ownership have recognized that the enterprise in which the bank holds an interest must confine its activities to those that are part of, or incidental to, the business of banking. *See, e.g.*, Interpretive Letter No. 380, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (December 29, 1986) (since a national bank can provide options clearing services to customers it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

The Partnership will engage in title insurance agency activities permitted for national banks or their operating subsidiaries under 12 U.S.C. § 92. Section 92 specifically authorizes a national bank located and doing business in a place having a population of less than 5,000 to act as the agent for fire, life, or any other insurance company. The authority to sell insurance under section 92 includes the authority to sell title insurance, as agent. *See, e.g.*, OCC Corporate Decision #97-13 (February 24, 1997) (approving operating subsidiaries to engage in selling title insurance pursuant to 12 U.S.C. § 92); Letter from Michael K. Hughes, Licensing Manager, OCC Southwestern District (March 5, 1997) (approving an operating subsidiary "to perform the activities of a title insurance agency as permitted under 12 U.S.C. 92."). In its application, the Bank has represented that the Partnership's activities will be limited to operating a title insurance agency in accordance with the provisions of Section 92[5] and that the Partnership's activities will be conducted in accordance with the principles set forth in OCC Interpretive Letter No. 753, *reprinted in* [1996-97 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-107 (November 4, 1996). Thus, we conclude that the activities to be conducted by the Partnership are activities that are part of, or incidental to, the business of banking. Therefore, 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 first acquires its ownership, but 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, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 3, 1996); Interpretive Letter No. 625, *reprinted in* [1993-1994

[5] The Bank's application initially stated that the "Partnership's activities will be limited to operating a title insurance agency in accordance with Section 92…and to those other activities that are a part of, or incidental to, the business of banking." The original draft of the Partnership Agreement discussed the business of the Partnership in broader terms. As previously noted, the Agreement has been revised and now clearly states that the business of the Partnership will be limited to operating a title insurance agency. The Bank understands that the approval to establish the Subsidiary to acquire an interest in the Partnership is based on the understanding that the activities of the Partnership remain so limited. The performance of any additional activities by the Subsidiary, whether as a member of the Partnership or otherwise, may only be undertaken in accordance with the provisions of 12 C.F.R. §5.34.

Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993). This ensures that the bank will not become involved in impermissible activities.

The Agreement clearly states that the Subsidiary has the right to prevent the Partnership from engaging in any particular activity if that activity is not a part of, or incidental to, the business of banking. In addition, the Agreement provides that the Subsidiary has a continuing, unconditional right to withdraw from the Partnership at any time. The second standard is, therefore, 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 liability. Legally, a limited partner in a Pennsylvania limited partnership is not personally liable for the obligations of the limited partnership. 15 Pa. C.S.A. § 8523. In addition, the Agreement provides that the Subsidiary is not personally liable for any of the debts, obligations or losses of the Partnership beyond its partnership interest.[6]

b. Loss exposure from an accounting standpoint

The Bank's accounting department and outside auditors have reviewed the Subsidiary's proposed investment in the Partnership and have concluded that the Subsidiary will account for its investment in the Partnership under the cost method of accounting. Under this method, losses recognized by the investor will not exceed the amount of the investment (including extensions of credit and guarantees, if any) shown on the investor's books. *See generally,* Accounting Principles Board, Op. 18 § 19 (1971). Thus, the Subsidiary's loss from an accounting perspective will be limited to the amount invested in the Partnership and the Subsidiary will not have open-ended liability for the obligations of the Partnership.

As indicated above, for both legal and accounting purposes, the Bank's potential loss exposure relative to the Partnership should be limited to the amount of its investment in the Partnership. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

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[6] See discussion on page 2 above regarding calculation of each partner's capital account. As noted in that discussion, in no event shall the Subsidiary be liable for any amount beyond the balance in its capital account. Furthermore, the Subsidiary shall not be required to make additional capital contributions except as the parties may by writing agree.

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.

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). 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. *See, e.g.*, Interpretive Letter No. 697, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); Interpretive Letter No. 380, *supra.*

The Bank notes that title insurance will be an integral part of its lending business and real estate-related operations. By entering the title insurance business, the Bank, through its Subsidiary, will be able to provide superior service to the Bank's existing and potential customers by providing title insurance and immediate access to an internally professionalized title insurance agency. Through the Subsidiary's investment in the Partnership, the Bank expects to quickly and efficiently enter into the title agency business. Moreover, the Bank believes it will gain experience and expertise through the Subsidiary's joint venture partner and that it will be able to leverage that experience and expertise for its own benefit and that of its customers.

For these reasons, the Subsidiary's investment in the Partnership 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.

Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we have concluded that the Bank may establish the Subsidiary to acquire and hold a 70 percent non-controlling interest in the Partnership in the manner and as described herein, subject to the following conditions:

1. the Partnership will engage only in activities that are part of, or incidental to, the business of banking;

2. the Subsidiary will have the right to prevent the Partnership from engaging in any activity that is inconsistent with condition number one, or will withdraw from the Partnership in the event the Partnership engages in an activity that is inconsistent with condition number one;

3. the Bank will account for its investment in the Partnership under the cost method of accounting; and

4. the Partnership will be subject to OCC supervision, regulation, and examination.[7]

Please be advised that these conditions 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.

If you have any questions, please contact Jane A. Principe, Senior Attorney at (215) 245-2606 or Linda Leickel, Licensing Analyst at (212) 790-4055.

Sincerely,

/s/

Raymond Natter
Acting Chief Counsel

[7] This condition has already been included as one of the terms of the Partnership Agreement.