Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 12, 1996

Interpretive Letter #836
September 1998
12 U.S.C. 24(7)

Dear [ ]:

This is in response to your letters of January 10, 1996 and February 9, 1996, requesting confirmation that [ ], [*City, State*] ("Bank"), may lawfully acquire and hold a minority interest in [ ] ("Company"), which is engaged in medical claims processing. The Company currently is owned by [ ] ("Holding Company") and [ ] ("Individual"). For the reasons set forth below, I agree with your conclusion.

BACKGROUND

The Bank intends to acquire a 49% interest in the Company, which will use automated data processing and electronic data interchange facilities to assist hospitals and physicians ("Providers") in communicating billing and payment-related information, including abbreviated diagnosis and treatment information, to entities responsible for providing medical benefits (government agencies, health maintenance organizations, and insurance carriers) ("Payers"), determining how much of the patient's bill is owed by the patient and how much is owed by the Payer, billing the Payer and the patient as appropriate, and facilitating payment by the patient and the patient's Provider, through funds transfer and credit card processing services, including the use of Bank-issued special purpose medical credit cards, when requested by patients.[1]

[1] Currently, the Company's medical claims processing, handled through its own self-developed software system, would be considered an information exchange network, since the Company is not a financial institution and cannot provide actual funds transfer services from Payers to Providers.

The Company will store, process, and retrieve documents and information needed to substantiate the medical claims being submitted and collect on past-due accounts owed to hospitals and physicians. It also will continue to maintain and operate the electronic data processing ("EDP") facilities of a hospital owned by an affiliate of the Company ("Hospital"). This activity will not generate more than 5% of the Company's gross revenues and will be done in conformity with the OCC's Interpretive Ruling 7.3500, 12 C.F.R. § 7.3500, as revised at 61 Fed. Reg. 4849, 4865 (1996) (to be codified at 12 C.F.R. § 7.1019) (effective April 1, 1996).

The Company's two shareholders, the Holding Company and the Individual, currently own 98.25% and 1.75% of the Company's stock, respectively. The Individual owns all the issued and outstanding stock of the Holding Company. The Bank,[2] the Holding Company and the Individual have entered into a Shareholders' Agreement ("Agreement') that includes the following provisions:

- The initial Board of Directors of the Company will consist of five directors. Two directors will be elected by the Holding Company, and two will be elected by the Bank. The fifth director position will be filled by the Company's chief executive officer, who will be mutually agreed upon by the Company and the Bank. Thereafter, the Board of Directors will be increased in multiples of two. The Bank and the Company shall have equal representation on the Board so long as each owns directly or indirectly 80% of the shares they will hold on the effective date of the Agreement.

- Major Decisions of the Company must be agreed to by the directors representing the Holding Company and the Bank. The term "Major Decision" includes amendments to the Articles of Incorporation or By-Laws of the Company; a merger or other business combination with another corporation whose assets or net worth is more than 33% of the assets or net worth of the Company; the acquisition of the Company by any other person; the acquisition by the Company of any other corporation or business whose assets or net worth are more than 33% of the assets or net worth of the Company; the sale of substantially all of the assets of the Company; the liquidation or voluntary dissolution of the Company; the selection of a Chief Executive Officer; and the registration of shares of the Company with the Securities and Exchange Commission for sale of such shares to the public.

- Directors representing the Holding Company and the Bank must adopt an annual business plan which, among other things, will assure that the Company will not do anything to jeopardize the Bank's compliance with regulatory requirements and that the

---

[2] The Bank was not an initial signatory to the Agreement but was assigned all the rights under the Agreement by a wholly-owned subsidiary of the Bank's parent company which did sign the agreement.

Company will not engage in any line of business which would necessitate the Bank's divestiture of its ownership in the Company, or the Company's divestiture of any significant activity or line of business of the Company. The Bank and the Holding Company also agree that the annual business plan will restrict the Company's business to the extent necessary to assure that the Company will qualify for pooling-of-interests accounting treatment under then current accounting provisions.

- Two primary provisions by which control of the Company may change subsequent to the closing are a put and call provision ("Put and Call") and a buy-sell provision ("Buy Sell"). The Put and Call permits the Bank to exercise a call option on an additional 18% of the Holding Company's stock in the Company under certain conditions. It also permits the Holding Company to cause the Bank to purchase 18% of those shares under certain conditions. You advise that the Put and Call would not necessarily increase the Bank's ownership because the Bank has the right to cause additional stock purchases to be made by its nominee or designee and because one of the primary purposes of the Put and Call is to prevent or minimize dilution, for example, upon the subsequent merger of the Company with another entity. The Buy Sell is applicable only so long as the Company and the Bank own at least 80% of what they own at closing and only if the parties cannot reach agreement on a Major Decision, as described above. Again, nominees are available to make the purchases.

ANALYSIS

The Bank's plan to purchase a 49% interest in the Company initially raises the issue of the authority of a national bank to hold a minority interest in a corporation. A recent OCC interpretive letter extensively analyzed the authority of national banks under 12 U.S.C. § 24(Seventh) to own stock, and reviewed OCC precedents on the ownership of stock in amounts less than that required for an operating subsidiary, *i.e.*, non-controlling stock investments. Interpretive Letter No. 697, [Current] Fed. Banking L. Rep. (CCH) ¶ 81-013 (Nov. 15, 1995). That letter concluded that ownership of a non-controlling interest in a corporation is permissible provided that four standards, drawn from OCC precedents, are satisfied. They 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; 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 factors is discussed below and applied to your proposal.

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.

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 to the conduct of the banking business. *See, e.g.*, 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); 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 a corporation operating such a network is permissible).

The Company's activities will involve automated data processing services to facilitate accounts receivable collections, billing, and related funds transfers for Providers. The OCC previously has approved the activities the Company will perform. The following summarizes our precedents.

National banks may use automated data processing to provide billing services and accounts receivable services for itself and others, Interpretive Letter No. 419, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,643 (Feb. 16, 1988) ("Letter 419"), and engage in data processing related to funds transfer, cash management, and credit extensions, *id.*, (funds transfer); Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (Dec. 13, 1985) (cash management); Interpretive Letter No. 611, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449 (Nov. 23, 1992) (cash management, funds transfer); Letter from Peter Liebesman, Assistant Director, Legal Advisory Services Division (Aug. 15, 1983) (credit extensions). The OCC also has approved electronic data interchange services for financial information, Interpretive Letter No. 653, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (Dec. 22, 1994) (informational and payments interface) and credit card processing, Interpretive Letter No. 689, [Current] Fed. Banking L. Rep. (CCH) ¶ 81-004 (Aug. 9, 1995).

The OCC, on several occasions, has found health insurance claims processing and related activities to be permissible. *See* Letter from Gail W. Pohn, Director, Bank Organization and Structure Division (Nov. 19, 1975) (providing doctors with an accounts receivable and billing system with inquiry and input capabilities); Letter 419 (settlement and payment of health insurance claims through the use of shared electronic funds transfer technology by linking

health care providers, insurers, recipients, and their respective depository institutions, transmitting claim eligibility information, receiving and transmitting information for claims entry and payment, operating a data base, accomplishing payment, and developing and licensing appropriate software programs to health care providers to permit their participation);[3] Letter from Jeanne N. Devine, Senior Attorney (May 26, 1994) (collection services are permissible).

The Company's continued maintenance, operation, and management of the EDP facilities of the Hospital will include patient accounting, medical records, payroll, general ledger, accounts payable, employee time and attendance, scheduling the provision of services, and fixed assets. The contract between the Company and the Hospital will produce less than 5% of the total projected gross revenues of the Company. Many of the services involve data processing which is permissible under the above analysis. To the extent some activities may fall outside that analysis, they properly may be considered "excess capacity." The Bank's acquisition of its interest in the Company is being done in good faith, not to engage in such activities. *See generally* 12 C.F.R. § 7.3500 *supra*.; Preamble discussion of 12 C.F.R. § 7.1019, 61 Fed. Reg. 4853-4854 (1996); Interpretive Letter No. 677, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995) (national banks permitted to acquire interests in a software company where 7% of its revenues are derived from nonfinancial software production and distribution); Interpretive Letter No. 345, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,516 (July 31, 1985) (sale of computer hardware usable for nonfinancial purposes as well as financial purposes approved where hardware does not exceed 30% of cost of entire package of banking and financial data processing services).

Thus, the activities to be performed by the Company 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.

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 purchases stock, but they must remain so for as long as the bank has an ownership interest. However, minority shareholders in a corporation do not possess a veto power as a matter of corporate law. One way to address this problem is for the corporation's articles of incorporation or bylaws to limit its activities to

[3] Letter 419 found that the transfer of funds from one account to another or from one institution to another is a fundamental part of the business of banking. The transmission of treatment information was found to be an integral part of and a proper incident to performing the funds transfer service.

those that are permissible for national banks. *See, e.g.*, Letters from Peter Liebesman, Assistant Director, Legal Advisory Services Division (January 26, 1981 and January 4, 1983).

Contractual solutions also are feasible. In the present case, the Bank, the Holding Company and the Individual have entered into a Shareholders' Agreement to address this concern. According to your letter, among other things, the Agreement provides that all Major Decisions must be approved by the affirmative vote of two-thirds of the directors, in absolute number. You have explained that this means the Bank and the Holding Company would have to approve all Major Decisions. Also, the Agreement requires that the Board adopt an annual business plan (among the items considered Major Decisions) which, among other things, includes actions to assure that the Company does not do anything to jeopardize the Bank's compliance with regulatory requirements and to assure that the Company will not engage in any line of business which would necessitate the Bank's divestiture of its ownership in the Company or the Company's divestiture of any significant activity or line of business.

These provisions assure that the Company will not engage in any activity that is not permissible for a corporation having a national bank shareholder. The Bank effectively will have a veto power over any impermissible activity as long as it continues to own shares in the Company. Thus, 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 national bank's investment not expose it to unlimited liability. Normally, this is not a concern when investing in a corporation, for shareholders are protected by the "corporate veil" from liability for the debts of the corporation. 1 William M. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 25 (perm. ed. rev. vol. 1990). In the present case, both the Company and the Bank will be separate corporations, with their own capital, directors, and officers.

Further, the Bank has been advised by its accountants, who have discussed the issue of limited loss exposure with the OCC's Office of the Chief Accountant, that the appropriate accounting treatment for its investment in the Company will be the equity method of accounting. Under this method, which is used for equity interests of 20 to 50 percent in corporations, 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. *See generally*, Accounting Principles Board, Op. 18, § 19 (1971) (equity method of accounting for investments in common stock).

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure should be limited to the amount of its investment (plus, potentially, the amount of any extensions of

credit that remain outstanding). Since that exposure will be quantifiable and controllable, the third standard is satisfied.[4]

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.

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." *Arnold Tours, Inc. v. Camp,* 472 F.2d 427, 432 (1st Cir. 1972). The provision in section 24(Seventh) relating to the purchase of stock, derived from section 16 of the Glass-Steagall Act, was intended only to make it clear that section 16 did not authorize speculative investments in stock. Interpretive Letter No. 697, *supra*. Therefore, a consistent thread running through our precedents concerning stock ownership is that such ownership must be convenient or useful to the investing bank in conducting its 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, [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (Feb. 13, 1991); Interpretive Letter No. 427, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (Mar. 14, 1988).

The Bank seeks the relationship with the Company in order to develop new financial data processing customers in the health care industry, which has proven difficult for the Bank to do on its own. The health care industry is an important sector of business within the Bank's market area, and it is doubtful the Bank would be able to develop a separate system in a timely and reasonably priced way. With its investment in the Company, the Bank will have access to the Company's successful payment processing business which can be integrated with other banking services provided by the Bank. The Bank also hopes, through its participation in the Company, to build relationships with Providers and insurance companies, and thereby obtain opportunities for cross-selling of banking products. The availability to the Company's customers of the Bank's funds transfer and credit card processing facilities will be convenient to them and should result in the development of a strong customer base for the Bank in the health care industry. Thus, this activity will be useful to the Bank in carrying out its banking business, and the fourth standard is satisfied.

---

[4] Whether exercising the Put and Call or the Buy Sell provisions of the Agreement would have an impact on the Bank's loss exposure as a legal or accounting matter cannot be determined unless such provisions are exercised. We do note your representation that the Bank's ability to designate nominees to purchase additional shares in the event these provisions are acted upon should enable it to avoid being placed in control of the Company against its wishes.

CONCLUSION

For the reasons outlined above, the Bank's investment in the Company would satisfy the four standards the OCC has applied to non-controlling minority investments. Our conclusion is conditioned upon the conditions listed below and compliance by the Bank with commitments made in connection with its request for a legal opinion:

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

2) the Bank will have veto power over any activities and Major Decisions of the Company that are inconsistent with condition 1), or the Bank will withdraw its investment in the Company if it proposes to engage in an activity that is inconsistent with condition 1);

3) the Company will be subject to OCC supervision and examination; and

4) the Bank will account for its investment in the Company under the equity method of accounting.

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

I hope that this has been responsive to your inquiry.

Sincerely,

/s/

Julie L. Williams
Chief Counsel