Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #970
July 2003
12 U.S.C. 24(7)

June 25, 2003

Subject: **[** ***Bank, City , State*** **]** ("***NB***")

Dear **[** **]**:

This is in response to your May 23, 2003 letter requesting confirmation that **[** ***NB*** **]** may lawfully acquire and hold a non-controlling equity interest in a limited purpose state-chartered bank ("Bank").

Facts

The Bank, now being organized, will be chartered in **[** ***State*** **]**. The Bank will engage only in activities that are permissible for a banker's bank under 12 U.S.C. §§ 24(Seventh) and 27(b).[1] However, the Bank will not actually meet the qualifications for a banker's bank set forth in section 27(b) since it will not be owned exclusively (except for directors' qualifying shares) by other depository institutions or depository institution holding companies. Although such entities will hold the majority of the Bank's shares, approximately twenty percent of the shares will be held by other shareholders. **[** ***NB*** **]**'s investment in the Bank is expected to be between $100,000 and $250,000, or between one and two-and-a-half percent of its capital. While **[** ***NB*** **]** may later invest additional amounts, you have represented that **[** ***NB*** **]**'s investment will at all times be less than five percent of the Bank's total shares.[2]

[1] 12 U.S.C. § 27(b)(1) provides that:

"The Comptroller of the Currency may also issue a certificate of authority to commence the business of banking pursuant to this section to a national banking association which is owned exclusively (except to the extent directors' qualifying shares are required by law) by other depository institutions or depository institution holding companies and is organized to engage exclusively in providing services to or for other depository institutions, their holding companies, and the officers, directors, and employees of such institutions and companies, and in providing correspondent banking services at the request of other depository institutions or their holding companies (also referred to as a 'banker's bank').

[2] Since **[** ***NB*** **]**'s investment in the Bank will at no time reach five percent, this proposal raises no issues under the Bank Holding Company Act, 12 U.S.C. § 1841 *et seq*.

The Bank will engage in the following activities: (1) taking deposits from depository institutions; (2) buying and selling loan participations; (3) engaging in lending transactions permissible for a banker's bank; and (4) providing correspondent services to depository institutions.

Discussion

The OCC has traditionally recognized the authority of national banks to organize and perform any of their lawful activities in a reasonable and convenient manner not prohibited by law.[3] In a number of interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in an enterprise provided four criteria or standards are met. These standards, which have been distilled from our previous decisions in the area of permissible non-controlling 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 (or otherwise authorized for a national bank).

(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.

Based upon the facts presented, **[*NB*]**'s proposed acquisition 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 (or otherwise authorized) for a national bank.

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….

[3] *See, e.g.,* Interpretive Letter No. 943, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-468 (July 24, 2002); Interpretive Letter No. 890, *reprinted in* [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-409 (May 15, 2000); Interpretive Letter No. 854, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-311 (Feb. 25, 1999); Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995).

The Supreme Court has held that this powers clause of 12 U.S.C. § 24(Seventh) is a broad grant of authority to engage in the business of banking, which is not limited to the five enumerated powers. Further, national banks are authorized to engage in an activity if it is incidental to the performance of the enumerated powers in the statute or if it is incidental to the performance of an activity that is part of the business of banking.[4]

All of the Bank's proposed activities are permissible for a national bank. Two of the activities—taking deposits and making loans—are among the enumerated powers specifically authorized under 12 U.S.C. § 24(Seventh).[5] The buying and selling of loan participations is also permissible.[6] Providing correspondent services to other depository institutions is authorized under the OCC Interpretive Ruling 7.5007, 12 C.F.R. § 7.5007.[7] 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. 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.

As a matter of corporate law, a minority shareholder in a corporation does not possess a veto power over corporate activities. Therefore, **[*NB*]** will lack the ability to restrict the Bank's activities to those that are permissible for a national bank. However, the OCC has accepted as satisfaction of this criterion a national bank's ability to divest itself of its investment in any enterprise that engages in an activity that is not permissible for a national bank. *See, e.g.,* Interpretive Letter No. 890, *supra,* n. 3. You have represented that nothing in the Bank's articles of incorporation or bylaws prohibit or restrict the ability of a shareholder to sell its shares in the Bank. Except for short-term limitations prescribed in the securities laws, any national bank that invests in the Bank is free to sell its shares if the Bank engages in any activity that is not permissible for a national bank. 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.

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[4] *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.,* 513 U.S. 215 (1995).

[5] As noted above, the Bank will engage in such transactions only with other depository institutions and not with the general public. Its proposed activities are therefore narrower than is permitted under 12 U.S.C. § 24(Seventh).

[6] *See, e.g.,* Interpretive Letter No. 755, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-119 (Oct. 3, 1996) ("[N]ational banks long have been able to purchase mortgage-backed securities and engage in loan participations. *See* 12 U.S.C. § 24(Seventh).")

[7] "It is part of the business of banking for a national bank to offer as a correspondent service to any of its affiliates or to other financial institutions any service it may perform for itself." 12 C.F.R. § 7.5007.

(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. This is not normally a concern when a national bank invests in a corporation, for it is generally accepted that a corporation is an entity distinct from its shareholders, with its own separate rights and liabilities, provided proper corporate separateness is maintained.[8] That is the case here. The Bank will be a **[*State*]** corporation and the corporate veil will protect **[*NB*]** from liability or loss associated with its investment.[9]

(b) Loss exposure from an accounting standpoint

In assessing a national bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's minority investment in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of accounting. *See, e.g.,* Interpretive Letter No. 943, *supra,* n. 3. You have represented that **[*NB*]** will account for its ownership interest in the Bank according to the cost method of accounting, which will satisfy the OCC's requirements in this regard.

Therefore, for both legal and accounting purposes, the **[*NB*]**'s potential loss exposure arising from its investment in the Bank should be limited to the amount of its investment. Since that exposure will be quantifiable and controllable, 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 convenient 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."[10] OCC precedents on non-controlling investments by national banks 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.[11]

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[8] 1 W. Fletcher, Cyclopedia of the Law of Private Corporations § 25 (rev. perm. ed. 1990).

[9] *See, e.g., Starfish Condominium Association v. Yorkridge Service Corporation, Inc.,* 295 Md. 693, 458 A. 2d 805 (1983).

[10] *Arnold Tours v. Camp*, 472 F.2d 427, 432 (1st Cir., 1972)

[11] *See, e.g.,* Interpretive Letter No. 943, *supra,* n. 3; Interpretive Letter No. 875, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-369 (Oct. 31, 1999); Interpretive Letter No. 890, *supra,* n. 3; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (Feb. 13, 1991).

In this instance, **[*NB*]**'s ownership interest in the Bank will be neither passive nor speculative, and this ownership interest will be convenient and useful for **[*NB*]**. The Bank will provide deposit and loan services to **[*NB*]**. In addition, the Bank will provide **[*NB*]** with an outlet for the buying and selling of loan participations and will also provide it with bank-related correspondent services permitted under 12 C.F.R. § 7.5007, *supra,* n. 7. Accordingly, the fourth standard is satisfied.

Conclusion

Based upon the information and representations you provided, and for the reasons discussed above, it is my opinion that **[*NB*]** may make a non-controlling equity investment in the Bank, subject to the following conditions:

(1) The Bank will engage only in activities that are permissible for a national bank;

(2) **[*NB*]** will divest its interest in the Bank in the event that the Bank engages in any activity that is inconsistent with condition (1);

(3) **[*NB*]** will account for its investment in the Bank under the equity or cost method of accounting; and

(4) The Bank will be subject to OCC supervision and examination, pursuant to 12 U.S.C. § 1867(c).

These conditions are conditions imposed in writing by the OCC in connection with this opinion letter stating that **[*NB*]**'s investment in the Bank is permissible under 12 U.S.C. § 24(Seventh). As such, these conditions may be enforced in proceedings under applicable law.

If you have any questions, please contact Sue Auerbach, Counsel, Bank Activities and Structure Division, at 202-874-4662.

Sincerely,

/s/ *Julie L. Williams*

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel