Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #305
April 1999

March 15, 1999

Thomas B. Hoyt, President
Hibernia Capital Corporation
313 Carondelet Street, 16th Floor
New Orleans, Louisiana 70130

Re: Application of Hibernia National Bank, New Orleans, Louisiana, to establish an operating subsidiary that will acquire non-controlling minority interests in two limited liability companies involved in financing small- and medium-sized businesses.
Application Control Number: 99-SW-08-0001

Dear Mr. Hoyt:

This is in response to your application dated January 19, 1999 on behalf of Hibernia National Bank, New Orleans, Louisiana ("Bank"),to establish an operating subsidiary that will acquire and hold a non-controlling minority interest in two limited liability companies ("LLCs"). The LLCs will invest in two different limited partnerships that are being formed for the purpose of facilitating investments in small- and medium-sized businesses. For the reasons set forth below, we approve the establishment of the operating subsidiary by the Bank, subject to certain conditions.

I. Background

The Bank proposes to establish an operating subsidiary, Hibernia ACP, L.L.C. ("HACP"), which will hold 20 percent non-controlling interests in two newly-formed LLCs, Audubon Capital Partners I, L.L.C. ("Capital Partners"), and Audubon SBIC Partners, L.L.C. ("SBIC Partners"). The other 80 percent interests in the LLCs will be held by four different members, each holding 20 percent interests. Capital Partners will be the sole general partner in Audubon Capital Fund I, L.P. ("Fund"); SBIC Partners will be the sole general partner in Audubon Capital SBIC, L.P. ("SBIC"). In addition, Fund will be the sole limited partner in SBIC.

The Fund, with working capital of between $10 million and $20 million, will provide financing for small- and medium-sized companies in Louisiana, East Texas, Arkansas, Mississippi,

Alabama, and the Florida panhandle, by making loans to and investing in the permissible securities of those companies. All investments by the Fund will be bank-permissible investments authorized under 12 C.F.R. Part 1. SBIC Partners will apply for a license from the United States Small Business Administration to operate SBIC as a small business investment company. As a small business investment company, SBIC will make loans and invest in securities permissible under the Small Business Investment Corporation Act.

Management of Capital Partners and SBIC Partners is governed by separate operating agreements, both of which provide HACP with authority to prevent the LLCs from engaging in any activity it determines would be impermissible under federal banking laws or regulations. Under the operating agreements, the LLCs' operations generally are conducted by managers who are appointed by the members. Action may be taken by the affirmative vote of two-thirds of the managers, unless HACP determines that the action would be impermissible, which would trigger a provision requiring the unanimous consent of the LLCs' members. Additionally, the Fund and SBIC may act only through their general partners, Capital Partners and SBIC Partners, respectively, which provides HACP with the authority to prevent the Fund and SBIC from engaging in any impermissible activities.

II. Discussion

A. National Bank Express and Incidental Powers (12 U.S.C. § 24(Seventh))

A national bank may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(d)(1). To qualify as an operating subsidiary, the parent bank must own at least 50 percent of the voting stock of the corporation. 12 C.F.R. § 5.34(d)(2). In this case, the Bank will own a 99 percent interest in HACP.[1] Whether conducted directly or through operating subsidiaries, making loans to small- and medium-sized businesses, and investing as authorized under 12 C.F.R. Part 1 in investment securities of small- and medium-sized businesses, are part of, or incidental to, the business of banking under 12 U.S.C. § 24(Seventh). In addition, national banks are expressly authorized to invest in small business investment corporations under 15 U.S.C. § 682(b).[2]

The remaining issue presented by your proposal concerns the authority of a national bank to hold--indirectly through an operating subsidiary--a non-controlling interest in an enterprise. A number of recent OCC Interpretive Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in a limited liability

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[1] The other 1 percent interest will be owned by HRE Corporation, a wholly-owned subsidiary of the Bank.

[2] Under this provision, a national bank is authorized to invest in one or more small business investment companies, up to an aggregate investment not to exceed 5 percent of its capital and surplus.

company. These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[3] 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.

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 conduct of the banking business.[4]

Under your proposal, Capital Partners and SBIC Partners will provide financing to small- and medium-sized businesses, through their investments in the Fund and SBIC. As discussed above, making loans to small- and medium-sized businesses, investing as authorized under 12 C.F.R. Part 1 in investment securities of small- and medium-sized businesses, and investing

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[3] *See, e.g.*, 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). *See also* 12 C.F.R. § 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 U.S.C. § 24(Seventh) and other statutes.

[4] *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).

in small business investment companies, are part of, or incidental to, the business of banking.[5] Specifically, investing in small business investment companies is expressly authorized for national banks under 15 U.S.C. § 682(b).

In addition, the investments in and management of the limited partnerships, pursuant to which Capital Partners and SBIC Partners will conduct their activities, are also permissible for national banks or their operating subsidiaries. National bank operating subsidiaries have been permitted to act as general partners in the past when it was shown that the underlying activity was permissible for banks, and the parent banks were shielded from unlimited liability that might arise from the activities of the other partners.[6] As noted above, the underlying activities of the proposed partnerships are part of, or incidental to, the business of banking.

Thus, we conclude that the activities to be conducted by the LLCs are 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.

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 interest, 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. This ensures that the bank will not become involved in impermissible activities.[7]

The operating agreements governing the LLCs' activities specifically provide that HACP has the authority to require any activity of the LLCs to be unanimously approved by the members, including HACP. Additionally, the operating agreements permit any member to sell or otherwise transfer its interest the LLCs, and thereby remove itself from participation in the LLCs.[8] Therefore, the second standard is satisfied.

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[5] *See* 12 U.S.C. § 24(Seventh); 12 C.F.R. Part 1; 12 C.F.R. § 5.34(e)(2)(ii)(L) (operating subsidiary regulation recognizing the authority of operating subsidiaries to engage in making, purchasing, selling, servicing, or warehousing loans or other extensions of credit, or interests therein, for the subsidiary's account, or for the account of others).

[6] *See* OCC Interpretive Letter No. 622, *reprinted in* [1993-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,504 (April 9, 1993); OCC Interpretive Letter No. 423, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,647 (April 11, 1988).

[7] *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 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993).

[8] The operating agreements restrict the transfer of a member's interest if such a transfer, when aggregated with any prior transfers, results in a sale or exchange within a 12-month period of 50 percent or more of the interests within the meaning of Section 708(b) of the Internal Revenue Code of 1986. The Bank has represented that it will

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. The corporate structures of the entities involved in the Bank's proposal will prevent the Bank from exposure to unlimited liability.

It is a principle of corporate law that members of a limited liability company are not liable for the debts of the company.[9] The Bank is therefore protected from debts that may arise from the activities of Capital Partners and SBIC Partners, by the protections afforded members of HACP, a Louisiana limited liability company. In addition, HACP is protected from unlimited liability arising from its investments in Capital Partners and SBIC Partners, both of which are Louisiana limited liability corporations, because of the same protections afforded members of these two LLCs. Further, the operating agreements of HACP, Capital Partners, and SBIC Partners provide specifically that no member shall be liable for the obligations of the LLCs beyond its capital contributions. Therefore, HACP will be protected from unlimited liability arising from the operations of Capital Partners and SBIC Partners, and the Bank will be protected from any unlimited liability arising from the operation of HACP. Thus, the Bank's loss exposure for the liabilities of HACP, Capital Partners and SBIC Partners will be limited by statute and by the agreements establishing the limited liability companies.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's 20-50 percent investment in a company is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books.

As proposed, Bank will have an ownership interest in Capital Partners and SBIC Partners of 20 percent each. Bank will account for its investment in the two companies under the equity method of accounting. Thus, Bank's loss from an accounting perspective would be limited to

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closely monitor the LLCs' activities, including the transfer of other members' interests, to determine the necessity for and possibility of restrictions on its withdrawal from the LLCs.

[9] *See* La. Rev. Stat. Ann. § 12:1320.B.

the amount invested in the companies and Bank will not have any open-ended liability for the obligations of the companies.

Therefore, for both legal and accounting purposes, Bank's potential loss exposure relative to Capital Partners and SBIC Partners should be limited to the amount of its investment in those entities. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

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."[10] 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.[11]

You have represented that providing small- and medium-sized business financing through Capital Partners, SBIC Partners, Fund and SBIC will increase the Bank's contacts with potential commercial customers, allow the Bank to provide more services to its commercial customers, and, because of the size of the loans and investments that will be made, provide a more cost-effective means of delivering the products and services to the target businesses. Therefore, the Bank's investment in Capital Partners and SBIC Partners will be convenient and useful to Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

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

[11] *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*.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may establish HACP as an operating subsidiary and hold, through HACP, 20 percent interests in Capital Partners and SBIC Partners. Our conclusion is conditioned upon the Bank's compliance with the following conditions:

1. Capital Partners and SBIC Partners will engage only in activities that are part of, or incidental to, the business of banking;

2. Bank, through HACP, will have effective veto power over any activities and major decisions of the Capital Partners and SBIC Partners that are inconsistent with condition number one, or will withdraw from those companies in the event they engage in an activity that is inconsistent with condition number one;

3. Bank, through HACP, will account for its investment in Capital Partners and SBIC Partners under the equity method of accounting; and

4. HACP, Capital Partners and SBIC Partners will be subject to OCC supervision, regulation, and examination.

Please be advised that the conditions of this approval are deemed to be "condition[s] 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 John W. Graetz, Licensing Expert (Financial Analyst), in Bank Organization and Structure at (202) 874-5060, or Brenda McNeese, NBE/Sr. Corporate Analyst, in the Southwestern District Office at (214) 720-7052.

Sincerely,

/s/

Julie L. Williams
Chief Counsel