Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 3, 2000

Interpretive Letter #883
April 2000
12 U.S.C. 24(7)

Dear **[ ]**:

This is in response to your letter of January 14, 2000, in which you notify the OCC of the intent of **[** ***Bank, City, State*** **]**("Bank"), to acquire a non-controlling interest in a newly formed limited liability company. We conclude that, subject to the conditions discussed below, the Bank may proceed with these acquisitions.

Bank's Proposal

The Bank, an indirect, wholly-owned subsidiary of **[ ]** Corporation, engages primarily in the issuance of consumer and business credit cards, including purchasing cards issued to federal, state, and local government and agencies. The Bank also offers credit card processing and related merchant services in connection with credit card transactions.

The Bank proposes to make a 50% non-controlling equity investment in a newly formed Delaware limited liability company ("LLC"). The remaining interest in the LLC will be owned by **[ ]**, Inc. (" "), a **[** ***State*****]** corporation with its principal place of business in **[** ***City, State*****]**. **[ ]**, a wholly-owned subsidiary of the **[ ]**, Inc., engages principally in the development of Internet-based procurement systems for state and local governments.

The Bank and **[ ]** propose to establish the LLC as part of their overall strategy of providing government credit card customers with the most convenient channels for accessing services and products. The LLC will enter into contracts with federal, state, and local governments and agencies to

provide a package of Internet-based services, which include (1) developing web sites that facilitate electronic procurement transactions, (2) hosting these web sites, and (3) providing related merchant processing services (collectively "Internet Services"). The Bank and **[ ]** have agreed to jointly market the Internet Services to government agencies throughout the country.

Analysis

Your letter raises the issue of the authority of a national bank to make a non-controlling investment in a limited liability company. The OCC has in a variety of circumstances concluded that it is lawful for a national bank to own, indirectly through an operating subsidiary, a minority interest in an entity or enterprise, such as a corporation, provided four criteria or standards are met.[1] 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 entity or enterprise 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 which are impermissible for national banks 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 four factors is discussed below and applied to your application.

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.

The OCC has found each of the activities included in the Internet Services to be part of, or incidental to, the business of banking and, therefore, authorized for national banks under 12 U.S.C. § 24(Seventh). We have previously determined that a national bank may provide a "package" of Internet-based services which includes developing and hosting web sites for government agencies and providing related merchant processing services.[2]

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[1] *See e.g.*, Interpretive Letter No. 855, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-312 (Mar. 1, 1999).

[2] Interpretive Letter from Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel (Mar. 3, 2000) (finding bank may develop and host web sites for government agencies) ("Williams Letter") (to be

In the Williams Letter, we concluded that hosting web sites for government agencies and providing an electronic communications pathway for product ordering and payment are finder activities authorized for national banks. The provision of these services brings potential purchasers and suppliers together for a transaction that they themselves negotiate and consummate. Accordingly, we conclude that the components of the proposed Internet Services that involve hosting of web sites for government agencies are permissible finder activities authorized for national banks pursuant to 12 U.S.C. § 24(Seventh).[3] Moreover, the provision of related merchant processing services is also clearly part of the business of banking.[4]

We have also approved the development of web sites for government agencies as incidental to other Internet-based services where the ability to develop the web sites was critical to the successful marketing of the package of services and the development was only a minor part of the entire Internet package offered.[5] Here, the development of web sites is needed to successfully market the Internet Services. Other providers of similar Internet-based services for government agencies include web site development in their package of services.[6] Without the web development component, the LLC will be at a competitive disadvantage relative to other providers of Internet commerce services to government agencies. Additionally, the web site development feature is only a minor part of the entire package offered by the LLC (on average gross profits from web site development will be less than 30% of the

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published). *See also* Interpretive Letter No. 856, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-313 (Mar. 5, 1999); Corporate Decision No. 97-60 (July 1, 1997) (national bank operating subsidiary maintaining and operating an Internet web site which provides information in pre-owned automobiles to potential buyers); OCC Conditional Approval No. 221 (December 4, 1996) (national bank making a minority investment in a company that provides an electronic "gateway" through which customers of bank will be able to obtain home banking and other financial services from their respective financial institutions through various electronic access devices).

[3] *Williams Letter*, *supra*.

[4] Conditional Approval No. 289 (October 2, 1998) (national banks may acquire a minority interest in a firm that, among other things, provides accounts receivable processing and accounts payable processing); Conditional Approval No. 248 (June 27, 1997) (national bank operating subsidiary may acquire a minority interest in an entity that provides merchant credit and debit card processing services); Interpretive Letter No. 731, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,048 (July 1, 1996) (national banks as part of the banking business may collect and process accounts relating to an electronic toll collection system).

[5] *Williams Letter*, *supra*. *See also* Interpretive Letter No. 875 (Oct. 31, 1999) (to be published), available at http://www.occ.treas.gov/interp/jan00/int875.pdf.

[6] *Williams Letter*, *supra*. *See also* Richard W. Walker, *Government Agencies Use EC Web Technologies' ecBuyer Electronic Commerce Software*, Gov't Computer News, September 20, 1999, p. 45; Frank Tiboni, *HCFA Updates Web Site*, Gov't Computer News, August 23, 1999, p. 6; J.B. Miles, *A Variation of Online-Auction Model Would Pay Off for Agencies*, Gov't Computer News, August 16, 1999, p. 46; J.B. Miles, *Online Malls Are Fast, Secure and Right at Your Desk*, Gov't Computer News, March 23, 1998, p. 79.

gross profits of the entire Internet Services package).[7] Under these circumstances, we find the web site development services to be incidental to the other Internet Services, and therefore authorized.

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 enterprise's activities are permissible at the time of the Bank's initial investment. They must also remain permissible for as long as the Bank retains a membership interest in the enterprise. The Bank represents that the LLC's incorporating and operating agreements will include a limitation on the activities of the LLC. These agreements will limit the activities in which the LLC may engage to those activities that are part of, or incidental to, the business of banking. Moreover, the Bank represents that it will have an effective veto over any activities that are not permissible for a national bank. Therefore, 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. *Loss exposure from a legal standpoint*

A primary concern of the OCC is that national banks 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. As a legal matter, investors in a Delaware limited liability company will not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Del.

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[7] Full function products provided as an incidental part of a package of banking services cannot dominate the banking services being provided. *See* Interpretive Letter No. 737, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-101 (Aug. 19, 1996); Interpretive Letter No. 516, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220 (July 12, 1990); Letter from Michael J. O'Keefe, District Counsel, Midwestern District (July 13, 1987) (unpublished); Interpretive Letter No. 345, *supra*. The OCC has two alternative tests for determining when sale of full function products as part of a package of banking services is sufficiently subordinate to those banking services. The older OCC test is whether the cost of the full function product is less than 30% of the cost of the entire package. Interpretive Letter No. 742, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking. L. Rep (CCH) ¶ 81-106 (Aug. 19, 1996). As an alternative to the cost test, a more recent letter adopted a test based on the percentage of "gross profits" (sales less cost of goods sold) that is derived from the sale of the hardware. Interpretive Letter No. 754, *reprinted in* [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-120 (Nov. 6, 1996). Specifically, this letter held that where the gross profits generated by a full function product provided in connection with a banking service do not exceed thirty percent of the total gross profits from that service, the sale of the full function product is incidental to the permitted banking service.

Code Ann. Tit. 6 ' 18-303 (1993). Thus, the Bank's loss exposure for the liabilities of the LLC will be limited by statute.

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 ownership share of investment in a limited liability 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. *See generally* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock).

As proposed, the Bank will have a non-controlling interest in the LLC. The Bank believes, and its accountants have advised, that the appropriate accounting treatment for the Bank's investment is the equity method.[8] Thus the Bank's loss from an accounting perspective would be limited to the amount invested in the LLC, and the Bank will not have any open-ended liability for the obligations of the LLC. The Bank's loss exposure is limited, as a legal and accounting matter. Therefore, 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 that is not an operating subsidiary of the bank must also satisfy the requirement that the investment have a beneficial connection to that bank's business, *i.e.*, it must be convenient or useful to the investing bank's business activities and not constitute a mere passive investment unrelated to the bank's banking business. Twelve U.S.C. § 24 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). Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to the bank in conducting that bank's banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.

This requirement is met in this case. The Bank's investment in the LLC is an integral part of the Bank's merchant credit card strategy. By investing in the LLC, the Bank will be offering its government card customers additional purchasing channels, thus improving the overall service capabilities of the Bank and the attractiveness of the Bank's government card and merchant processing products and services. In

[8] OCC's Chief Accountant has concluded that the Bank's investment in the LLC should be recorded as Investments in "unconsolidated subsidiaries and associated companies" on the Bank's Consolidated Reports of Condition and Income ("Call Reports"). Such classification is consistent with the Call Report Instructions. *See* Instructions to Schedule RC- M, item 8.b.

addition, the Bank's investment in the LLC will result in additional merchant processing income. Therefore, the fourth standard is satisfied.

Conclusion

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

(1) The LLC will 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 LLC that are inconsistent with condition number one, or will withdraw from the LLC in the event it engages in an activity that is inconsistent with condition number one;

(3) The Bank will account for the investments in the LLC under the equity method of accounting; and,

(4) The LLC will be subject to OCC supervision, regulation, and examination.

Please be advised that the conditions of this approval are deemed to be "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 and, as such, may be enforced in proceedings under applicable law.

This approval is granted based on a thorough review of all information available, including the representations and commitments made in the application and by the Bank's representatives.

If you have any questions, please contact Steven V. Key, Attorney, Bank Activities and Structure Division, at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel