Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #225
December 1996

November 27, 1996

Mr. Larry P. Cole
Vice President and Counsel
First Tennessee National Corporation
P.O. Box 84
Memphis, Tennessee 38101

Re: First Tennesse Bank, N.A., Memphis, Tennessee
Proposal to expand activites of an operating subsidiary
Application Control Number: 96-SE-08-0017

Dear Mr. Cole:

This is in response to your letter of August 30, 1996, addressed to our Southeastern District Office, in which you notify the OCC of the intent of First Tennessee Bank, N.A., Memphis (the Bank) to perform new activities in its operating subsidiary, FT Mortgage Companies (the Subsidiary). We conclude that, subject to the conditions discussed below, the Bank may proceed with its plan for the Subsidiary to make a non-controlling investment in a Tennessee limited liability company that will originate and service multifamily loans.

Bank's Proposal

As described in your correspondence and telephone conversations with OCC staff, the Subsidiary, a Kansas corporation, with its principal office in Dallas, Texas, is a second-tier, wholly-owned subsidiary of the Bank. It is a licensed mortgage company that conducts a nationwide mortgage banking business. The Subsidiary currently originates and services residential mortgage loans on 1- to 4-family properties and it has originated and currently services a portfolio of approximately 170 multifamily loans with a principal balance of approximately $780,000,000. The Subsidiary will make an investment in CPC Mortgage Capital, L.L.C. (the LLC), a limited liability company that will originate and service multifamily loans. In exchange for its 49 percent interest in the LLC, the Subsidiary will contribute the servicing rights to the multifamily portfolio that is currently valued at approximately $6,000,000. In addition, the Subsidiary will make a direct cash investment of approximately $4,500,000. The remaining 51 percent interest in the LLC will be held by Carter Primo Chesterton Limited Partnership (CPC), a real estate investment firm and minority business enterprise, that will contribute a cash investment of $500,000 as well as its management expertise and servicing capabilities.

The Bank's objective is to transfer the servicing of the multifamily loans currently held by the Subsidiary to the LLC while the Subsidiary continues to originate and service 1- to 4-family loans. The LLC will originate any new multifamily loans and will retain the servicing rights on the multifamily loans which it originates. The Bank believes that this transfer of business to the LLC will reduce the Bank's risk and increase the efficiency of its multifamily loan operations.

The LLC will be organized as a Tennessee limited liability company with its principal office located in Chicago, Illinois, which also is the main office location of CPC. The LLC will qualify as a minority business enterprise. The business of the LLC will be to act as a Federal National Mortgage Association (FNMA) Delegated Underwriting and Servicing ("DUS") Lender, a multifamily servicer for the Government National Mortgage Association (GNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), and a Housing and Urban Development/Federal Housing Association (HUD/FHA) approved Coinsuring Mortgagee. The Subsidiary currently performs these business activities which will be transferred to the LLC. The Subsidiary has recourse on certain loans made pursuant to its role as FNMA DUS Lender, and HUD/FHA approved Coinsuring Mortgagee which, upon receipt of approval from HUD and FNMA, will be transferred to the LLC. As a condition to their approval of this transfer, both FNMA and HUD will require the LLC to meet certain capitalization and other requirements, which the Bank has stated the LLC will meet.

The Subsidiary and CPC will enter into an Operating Agreement which generally gives the members full authority to manage and control the business and affairs of the LLC. Each Member has power to bind the LLC, but only to the extent provided in the Tennessee Limited Liability Company Act, Tennessee Code Annotated (Tenn. Code Ann.) §§ 48-201-101 to 48-248-606. Notwithstanding this authority, unanimous consent of members is needed, among other things, to amend the Operating Agreement, cause the LLC to incur debt or make capital expenditures exceeding specified amounts, or do any act which is not a permitted business activity of a national bank or is not part of, or incidental to, the business of banking. Operating Agreement, Article V, § 5.3. The LLC's Management Committee shall consist of four individuals, two each selected by the Subsidiary and CPC. Unanimous consent of the Management Committee is required to approve the business plan of the LLC as well as recommend investment policies and guidelines, originate mortgage loans, make investments on behalf of the LLC, and approve annual budgets. *Id.* The Operating Agreement also gives each member the right of first refusal to purchase the interest of the other members in the event any member proposes to convey its interest. Operating Agreement, Article XIII, § 13.2.

Finally, it should be noted that, after its initial contribution, the Subsidiary is not required to make any additional mandatory capital contributions to the LLC. Moreover, after the establishment of the LLC, no Bank funds will be loaned to the LLC's borrowers. It is intended that the LLC will rely on outside sources of funding for its loans.

Analysis

A national bank may engage in activities that are part of or incidental to the business of banking by means of an operating subsidiary. The Bank previously received OCC approval, pursuant to 12 C.F.R. § 5.34, to establish the Subsidiary to engage in mortgage lending and related services. The Bank, pursuant to 12 C.F.R. § 5.34(d)(1), now notifies the OCC of its intent to perform new activities in the Subsidiary.

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 make a non-controlling investment in an entity or enterprise, such as a limited liability company,[1] provided four criteria or standards are met. *See e.g.*, Interpretive Letter No. 694 (December 13, 1995) *reprinted in* [1995- 1996 Transfer Binder], Fed. Banking L. Rep. ¶ 81,009; Interpretive Letter No. 692, (November 1, 1995) *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007. These standards, which have been distilled from our previous decisions in the area of permissible minority 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.

Applying these four standards to the facts presented, I conclude, as discussed below, that the Bank's proposal satisfies these 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.*

It is clear that the proposed activities of the LLC, i.e, the origination and servicing of residential real estate loans, are legally permissible. National banks have express authority under 12 U.S.C. § 24 (Seventh) to make loans. Incidental to this authority, national banks may service loans. National banks also have authority under 12 U.S.C. § 371 to make, arrange, purchase, or sell loans or extensions of credit secured by liens on interests in real estate. *See e.g.*, Interpretive Letter No. 694, *supra*; Interpretive Letter No. 645 (April 29, 1994), *reprinted in* [1994 Transfer Binder], Fed. Banking L. Rep. (CCH) ¶ 83,554. Therefore, I conclude that the proposed activities are part of, or incidental to the business of banking, under 12 U.S.C. § 24 (Seventh). Accordingly, the first standard is satisfied.

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[1] In other recent letters, the OCC has permitted national banks to make non-controlling investments in a n enterprise other than a limited liability company, provided the investment satisfies these four standards. *See* Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012; Interpretive Letter No. 705 (October 25, 1996) *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81,020.

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 LLC's activities are permissible at the time of the Subsidiary's initial investment. They must also remain permissible for as long as the Subsidiary retains a membership interest in the LLC.

The LLC will be established under the laws of Tennessee. The Tennessee Limited Liability Company Act provides that a limited liability company may be organized for the purpose of "engaging in any lawful business unless a more limited purpose is set forth in its articles." Tenn. Code Ann. § 48-203-101(a) (1995). The Operating Agreement provides that the business of the LLC "shall at all times be consistent with the permitted business activities for a national banking association and its subsidiaries and shall be part of, or incidental to, the business of banking." Operating Agreement, Article III, § 3.1. The Operating Agreement also provides that the Subsidiary has the right, in its sole option and at its sole discretion, to dissociate with or cease to be a member of the LLC if the LLC "has commenced activities which are inconsistent with the permitted business activities of a national banking association and its subsidiaries or are not a part of, or incidental to, the business of banking." Operating Agreement, Article XV, § 15.2. Moreover, if the Subsidiary must dissociate with the LLC as a result of the LLC performing impermissible activities, the dissociation shall be effective as of the date and time that the LLC began engaging in the activity. *Id.*

The Subsidiary's role as a member of the LLC and its presence on the Management Committee helps to assure its significant influence over the LLC's business activities. Thus, the Bank, through the Subsidiary, is in a position to prevent the LLC from engaging in activities that are impermissible for a national bank. The Subsidiary also is able to dissociate and withdraw its investment if the LLC engages in impermissible activities. 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.*

This standard reflects the OCC's concern that national banks should not be subjected to undue risk of loss. If an investing bank, either directly or through an operating subsidiary, will not control the operations of the entity in which it holds an interest, it is important that a bank's investment not expose it to unlimited liability.

The Subsidiary's investment in the LLC will not, from a legal standpoint, expose the Bank to unlimited liability. The Tennessee Limited Liability Company Act provides --

> a member . . . of an LLC does not have any personal obligation, and is not otherwise personally liable, for the acts, debts, liabilities, or obligations of the LLC whether such arise in contract, tort or otherwise. A member . . . of an LLC does not have any personal obligation and is not otherwise personally liable for the acts or omissions of any other member . . . of the LLC. Notwithstanding the above, a member . . . may become personally liable in contract, tort, or otherwise by reason of such person's own acts or conduct.

Tenn. Code Ann. § 48-217-101(a) (1995). [2] In addition, the Operating Agreement provides that no member will be liable for any debt, obligation, or liability of the LLC, or for the acts or omissions of any member, except to the extent of the member's investment in the LLC and any obligation to return capital contributions or distributions made to members when property of the LLC is insufficient to pay all of its liabilities. Operating Agreement, Article V, §§ 5.5, 5.6. *See also* Tenn. Code Ann. § 48-236-105 (1995). Thus, the Bank's loss exposure for the liabilities of the LLC will be limited by statute and the Operating Agreement establishing the LLC.

Moreover, the Bank will account for its investment in the Subsidiary by reporting it as an unconsolidated entity under the equity method of accounting. In previous opinions, the OCC, in assessing a bank's loss exposure as an accounting matter, has noted that the appropriate accounting treatment for a bank's 20 to 50 percent ownership share or 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 extended a loan to the entity, guaranteed any of its liabilities, or has other financial obligations to the entity, losses are generally limited to the amount of the investment shown on the investor's books. *See generally* Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Under this equity method of accounting, an investing bank's maximum risk of loss should be limited to the amount of its respective investment in the limited liability company plus potentially, the amount of any additional extensions of credit or guarantees.

Thus, the Bank's loss exposure will be limited from both a legal and accounting matter, and the Bank will not have open-ended liability for the obligations of the LLC. Therefore, the third standard is satisfied.

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[2] Under the Tennessee Limited Liability Company Act, if a limited liability company's articles specifically identify members who will be personally liable for all debts, obligations and liabilities of the LLC, those persons shall be liable to the same extent as a general partner in a general partnership. Tenn. Code Ann. § 48-217-101(f). The Bank has stated that its articles will not designate any members that will be personally liable.

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). The provision in 12 U.S.C. § 24 (Seventh) relating to the purchase of stock, derived from section 16 of the Glass-Steagall Act, was only intended to make it clear that section 16 did not authorize speculative investments in stock. *See* Interpretive Letter No. 697 (November 15, 1995), *reprinted* in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012. 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.

The Bank has stated that the Subsidiary's investment in the LLC will benefit both the Bank and its customers. The investment in the LLC will result in increased profit opportunities for the Bank. The LLC's origination, packaging, and servicing of the multifamily loans will increase the efficiency of the Subsidiary's multifamily lending operations. Although the Bank intends to remain active in the multifamily loan business, it would be cost prohibitive for it to hire and maintain the quality of personnel needed to remain competitive. The senior management and staff of the LLC will primarily be individuals currently employed by CPC who have significant experience in real estate and asset management. The Bank expects that it will realize increased profits without any significant increase in overhead costs. This should enable the Bank to improve its regulatory capital position and reduce its level of risk.

The Bank also anticipates that this investment will provide increased opportunities for multifamily financing. The LLC will originate and service multifamily mortgage loans and will place special emphasis on originating multifamily loans in the urban and inner-city area. The Bank will not be making a passive financial investment, but rather will invest a significant amount of cash and multifamily servicing rights to the LLC in continuance of a business activity that was formerly performed in its operating subsidiary.

Thus, the establishment of the LLC is related to the Bank's business and would be convenient and useful to it in carrying out its banking business. Therefore, the fourth standard is satisfied.

Conclusion

Based upon the representations made on behalf of the Bank and for the reasons outlined above, we conclude that the Bank is legally permitted to make a non-controlling investment in the LLC, provided the Bank complies with the following conditions:

1) The LLC will engage only in activities that are part of or incidental to the business of banking;

2) The LLC will limit its activities to those permissible for national banks or the Bank will withdraw from the LLC in the event the LLC engages in an activity that is inconsistent with condition #1;

3) The Bank will account for its investment 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 all conditions of this approval 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 John O. Stein II, Licensing Manager, Southeastern District Office, (404) 588-4525.

Sincerely,

/s/

Steven J. Weiss
Deputy Comptroller
Bank Organization and Structure