Office of the Comptroller of the Currency

Interpretive Letter #745

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August 26, 1996

[ ]

Re: Participation in [ ] Business Trusts by [ ]

Dear [ ]:

This is in response to your June 7, 1996 letter concerning a proposal by [ ] ("Banks"). Each of the three Banks proposes to acquire certificates of participating interest in separate [ ] business trusts ("Business Trusts" or "[ ]'s Business Trusts"). The [ ]'s Business Trusts are being created for the sole purpose of holding and managing substantial portions of their respective Banks' investment securities portfolios. For the reasons given below, it is our opinion that these transactions are legally permissible in the manner and as described herein.

Facts

The Banks are subsidiary banks of [BHC] ("[ ]'s"), a bank holding company headquartered in [ ]. The Banks' investment portfolios typically consist of government agency obligations, municipal bonds, and securitized asset obligations. Currently, the [ ] ("[ ]'s lead bank"), centrally manages the Banks' investment portfolios.

Each of the Banks proposes to participate in a separate Business Trust organized pursuant to the Delaware Business Trust Act, Del. Code Ann. tit. 12, 3801- 3920 (1995), for the purpose of holding and managing that particular Bank's investment portfolio. In accordance with Delware law, the Banks propose to form the Business Trusts by entering into separate Trust Agreements with the trustees. The Delaware Business Trust Act requires that at least one of the trustees for a business trust must be a resident of Delaware for an "individual trustee" or have its principal place of business in Delaware for a "corporate trustee." Del. Code Ann. tit. 12, 3807 (1995).

Each of the [ ] Business Trusts would have a total of four trustees, consisting of one corporate trustee and three individual trustees. The Business Trusts would share the same corporate trustee and two of the same individual trustees. The proposed corporate trustee is [ ], a national bank with its principle place of business in Delaware, and the two shared individual trustees are vice presidents from [ ]'s lead bank. In addition, each of the Banks would have a vice president from that particular Bank as an individual trustee for its Business Trust.

After the Trust Agreements are signed, each of the Banks would then transfer between forty and

sixty-five percent of its investment portfolio to its respective Business Trust. In turn, each Bank would receive one or more "Trust Certificates" evidencing that Bank's beneficial ownership interest in its Business Trust. Thereafter, each Bank may make additional contributions to its respective Business Trust and would receive additional Trust Certificates. All of the Business Trusts would be administered from an office located in [ ].

In your letter, you indicate that the corporate trustee would not assume an active role in the management of the Business Trusts. Therefore, the three individuals effectively managing and controlling each Bank's investment portfolio would be an officer representing the individual

Bank and two officers from [ ] lead bank. Furthermore, each of the Trust Agreements specifically states that if the trustees invest trust funds in an investment that is not permissible for a national bank, then the Bank may direct the trustees to terminate such investment.

The trustees must then terminate such investment. *See* Trust Agreement 6.2.2. Finally, you have confirmed that pursuant to the Trust Agreements, the trustees would manage, invest, and reinvest cash, U.S. government obligations, and other marketable securities in accordance with each individual Bank's investment guidelines as approved by its Board of Directors.

In summary, each Bank would be the sole beneficial owner of the assets held by its respective Business Trust and the sole holder of the Trust Certificates. Although these Trust Certificates are freely transferable, you indicate that the Banks currently have no plans to divest their ownership in the Trust Certificates. The Banks' investment portfolios are currently being managed by [ ]'s lead bank, and thus, the Banks' proposals to participate in the Business Trusts merely reflects a reorganization in the structure of their investment portfolio management. Finally, you indicate that the purpose of the Banks' participation in the Business Trusts is to gain more favorable [ ] tax treatment and facilitate management centralization for the Banks' investment portfolios.

Discussion

Although the Office of the Comptroller of the Currency ("OCC") has routinely permitted national banks to establish operating subsidiaries to hold and manage their investment portfolios, your letter presents the use of Delaware business trusts for this purpose. Delaware business trusts are hybrid entities possessing features of both corporations and partnerships. The Delaware Business Trust Act defines a "business trust" as:

> [A]n unincorporated association which (i) is created by a trust instrument under which property is or will be held, managed, administered, controlled, invested, reinvested and/or operated . . . by a trustee or trustees for the benefit of such person or persons as are or may become entitled to a beneficial interest in the trust property . . . and (ii) files a certificate of trust pursuant to 3810.

Del. Code Ann. tit. 12, 3801 (1995).

Thus, your letter raises the issue of the authority of a national bank to be a majority participant in a Delaware business trust. In a variety of circumstances and under certain conditions, the OCC has concluded that it is lawful for a national bank to participate in different business enterprises. For example, the OCC has concluded that a national bank may own a minority interest in a business trust created to provide electronic data processing services on a cooperative basis to member financial institutions. *See* Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division (Apr. 28, 1988) (LEXIS, Bankng library, OCC.PL). Furthermore, the OCC has concluded that it is lawful

for a national bank to own both minority and majority interests in limited liability companies. *See, e.g.*, Letter of Julie L. Williams, Chief Counsel, to Jeffery E. Smith, Banc One Corporation (July 1, 1996) ("Banc One Letter"); Interpretive Letter No. 692, [Current] Fed. Banking L. Rep. (CCH) 81,007 (Nov. 1, 1995); Interpretive Letter No. 657, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,605 (Mar. 31, 1995); Interpretive Letter No. 645, [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,554 (Apr. 29, 1994).

In approving a national bank's majority participation in a business entity, the OCC has applied the following three factors which are distilled from relevant case law: (1) the entity's underlying activities must be permissible pursuant to 12 U.S.C. 24(Seventh) as part of, or incidental to, the business of banking; (2) the bank must have the power to influence and prevent the entity from engaging in activities that are impermissible for national banks; and (3) the bank must be shielded from unlimited liability for the acts of the entity. Each of these three standards is discussed below and applied to your proposal.

1. *The activities of the Business Trusts must be limited to activities that are part of, or incidental to, the business of banking.*

Pursuant to 12 U.S.C. 24(Seventh), a national bank "may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe." Thus, national banks have the express authority to purchase certain investment securities. The OCC's "Investment Securities Regulation," 12 C.F.R. 1 (1996), prescribes limitations and restrictions on the purchase of investment securities by a national bank for its own account.

The [ ] Business Trust Agreements expressly provide that the investment activities of the Business Trusts are limited to those permissible for a national bank. *See* Trust Agreement at p. 4-5 ("the term 'Eligible Investments' does not include investments in which a national bank is precluded from investing under Applicable Law"). Therefore, the proposed activities of the Business Trusts --the holding and managing of the Banks' investment securities portfolios in accordance with national banking laws and OCC regulations -- are clearly part of, or incidental to, the business of banking.

2. *The Banks must be able to prevent the Business Trusts from engaging in activities that do not meet the foregoing standard.*

This is an obvious corollary to the first standard. It is insufficient that the Business Trusts' activities are permissible at the time the Banks initially transfer their investment portfolios; they must also remain permissible for as long as the Banks participate in the Business Trusts.

The Trust Agreements specifically state that the trustees would make investment decisions within the investment guidelines adopted by the Board of Directors for each Bank. Moreover, the Trust Agreements provide that "[i]n the event the Trustees invest the Trust Estate, or any portion thereof, in an investment which is not an Eligible Investment [as defined above] any Holder which is a national bank may direct the Trustees to terminate such investment, in which case the Trustees must terminate such investment." Trust Agreement 6.2.2. Therefore, the Banks would have the power to prohibit the trustees from engaging in investment activities that are impermissible for national banks.

3. *The Banks' loss exposure must be limited and the Banks must not have open-ended liability for the obligations of the Business Trusts.*

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an

investing bank has sufficient control over the operations of an entity in which the bank holds a one hundred percent interest, it is unlikely that the bank's investment exposes it to unlimited liability. Here, the Banks' control over the operations of the Business Trusts is demonstrated in two ways. First, an officer representing the particular Bank involved would be one of the three trustees responsible for managing the day-to-day business activities of that Bank's Business Trust. Second, the trustees have agreed to make investment decisions within the investment guidelines adopted by each Bank's Board of Directors. Thus, it is unlikely that the Banks' participation in the Business Trusts would expose them to unlimited liability.

Furthermore, Delaware law, to which the [ ] Business Trusts are subject, states that "[e]xcept to the extent otherwise provided in the governing instrument of the business trust, the beneficial owners shall be entitled to the same limitation of personal liability extended to stockholders of private corporations for profit organized under the general corporation law of the State." Del. Code Ann. tit. 12, 3803(a) (1995). The Trust Agreements specifically state that "the [beneficial] Owners are entitled to the same limitation of personal liability extended to stockholders of private corporations for profit organized under the general corporation law of the State of Delaware." Trust Agreement 2.9. Therefore, as a legal matter, investors in a Delaware business trust would not incur liability with respect to the liabilities or obligations of the Delaware business trust solely by reason of being a beneficial owner of the Delaware business trust -- even if they actively participate in the management or control of the business. *See* Del. Code Ann. tit. 12, 3803(a) (1995). Thus, the Banks' loss exposure for the Business Trusts' liabilities would be expressly limited by statute and by the Trust Agreements.

Finally, the OCC has previously noted that the appropriate accounting treatment for a bank's ownership of more than fifty percent interest in an entity raises the presumption of control over that entity. *See* Banc One Letter, *supra;* Interpretive Letter No. 692, *supra*. For the reasons

discussed above, the Banks would have effective control over the affairs of their respective Business Trusts. You have also indicated that the Business Trusts would be subject to periodic audit by their respective Banks' internal and external auditors and to other review procedures imposed by the Banks. In addition, the Business Trusts would be subject to examination and supervision by the OCC in the same manner and to the same extent as the Banks.

Each of the Banks would therefore be required to report its Business Trust on a consolidated basis. In other words, the book figures for each of the Business Trusts would be consolidated with those for its respective Bank for the purpose of applying applicable statutory limitations such as 12 U.S.C 56, 60, 84 and 371d. Because each of the Banks would ultimately control its respective Business Trust, when the Business Trusts are consolidated, any losses attributable to the Business Trusts would be the result of the Banks' actions, and not any other member or third party. Therefore, the Banks' loss exposure should be within their control.

Conclusion

In sum, it is our opinion that the Banks are legally permitted to participate in the Business Trusts as described herein, provided:

1. The Business Trusts will only engage in activities that are part of or incidental to the business of banking;
2. The Banks will have veto power over any activities or major decisions of the Business Trusts that

are inconsistent with the above requirement; and

3. The Business Trusts will be subject to OCC regulation, supervision, and examination.

If you have any questions, please contact Leslie G. Linville, Midwestern District Counsel, or Madelynn R. Orr, Attorney, at (816) 556-1870.

Sincerely,
/s/
Julie L. Williams
Chief Counsel