Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #241
May 1997

May 1, 1997

Robert L. Andersen
Senior Vice President
First Union National Bank of North Carolina
One First Union Center
301 South College Street
Charlotte, North Carolina 28288

Re: Application by First Union National Bank of North Carolina to Establish an Operating Subsidiary Organized as a Limited Liability Company which will Invest in a General Partnership that will engage in Mortgage Banking Activities - Application Control Number: 97-ML-08-0005

Dear Mr. Andersen:

This is in response to the application filed by First Union National Bank of North Carolina ("First Union" or "the Bank") with the OCC pursuant to 12 C.F.R. § 5.34. We have now completed our review and your application is hereby approved. For the reasons given below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

BACKGROUND

First Union wishes to establish an operating subsidiary, First Union Institutional Mortgage Services, LLC, a North Carolina limited liability company ("FUMIS" or "the Company"). First Union Commercial Corporation ("Commercial"), a North Carolina corporation and a wholly owned subsidiary of First Union, will be the sole member of FUMIS. FUMIS will be managed by managers that are currently officers of the Bank or its affiliates.

FUMIS will then acquire 50% of Maher & Company, a Pennsylvania general partnership (the "Original Partnership") owned by Thomas J. Maher & Company, Inc., a Pennsylvania corporation, and Thomas J. Maher & Company of New Jersey, Inc., a New Jersey corporation

(collectively, "TJM"). The Original Partnership will then be reconstituted as a Delaware general partnership under the name of "First Union/Maher Partners" ("the Partnership").

The Partnership will engage in the following activities:

(1) providing commercial mortgage banking services for other lenders, including arranging loans or extensions of credit secured by liens or interests in residential or commercial real estate[1];

(2) advising clients relative to their real estate and real estate financing, including the purchase and sale of real estate, real estate mortgages and other debt obligations secured by real estate and equity interests and securities related to real estate[2];

(3) acting as a finder and bringing together parties wishing to finance the purchase, construction, development, operation or placement of real estate, equity interests, and securities related to real estate[3];

(4) representing borrowers in loan restructuring, workouts and bankruptcies[4]; and

(5) providing asset management services for holders of commercial real estate[5].

The management, operation and control of the Partnership will be vested in the management committee. All powers of the Partnership for which approval by the partners is not expressly required by the partnership agreement or other applicable law, will be exercised by the management committee, and the business and the affairs of the Partnership will be managed by, or be under the direction and control of the management committee.

The management committee will consist of a representative and substitute representative of FUMIS and TJM. The management committee may appoint such officers of the Partnership who will have the authority and duties prescribed by the partnership agreement relating to the day-to-day management and administration of the Partnership, who will serve, subject to the

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[1] Pursuant to a national bank's authority to engage in lending-related activities under 12 C.F.R. § 5.34(e)(2)(ii)(L).

[2] Pursuant to 12 C.F.R. § 5.34(e)(2)(ii)(J).

[3] Pursuant to 12 C.F.R. §§ 5.34(e)(2)(ii)(J) and 7.1002. Additionally, the Partnership will conduct real estate equity financing activities subject to the conditions specified in Interpretive Letter No. 271, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,435 (September 21, 1983) and Interpretative Letter No. 387, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,611 (June 22, 1987).

[4] Pursuant to 12 C.F.R. § 5.34(e)(2)(ii)(J).

[5] Pursuant to 12 C.F.R. § 5.34(e)(2)(ii)(J).

provisions of the partnership agreement, until their respective successors are duly appointed and qualified.

The approval of the majority-in-interest of the management committee of at least one of the members of the management committee selected will be required to authorize, among other things, certain actions relating to the debts and liabilities of the Partnership, entering into material contracts, disposing of the assets of the Partnership and changes in senior management.

The approval of the majority-in-interest of the partners will be required to authorize, among other things, amendments to the partnership agreement, subjecting the partners to personal liability, mergers and other reorganizations, and a change in the business of the Partnership.

DISCUSSION

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

The Bank's application raises the issue about the authority of a national bank to hold, through an operating subsidiary organized as a Limited Liability Company ("LLC"), a non-controlling 50 percent interest in a general partnership that will engage in mortgage banking activities.[6] A number of recent OCC Interpretative Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in an enterprise. *See, e.g.*, Interpretative Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-013 (November 15, 1995); Interpretative Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996). These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[7] 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;
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> 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;

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[6] The OCC recently amended its operating subsidiary rule, 12 C.F.R. 5.34, as part of a general revision of Part 5 under the OCC's Regulation Review Program. Operating subsidiaries in which a national bank may invest include corporations, limited liability companies, or similar entities if the parent owns more than 50% of the voting interest. Here, First Union will wholly own the LLC.

[7] *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.

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.

Each of these factors is discussed below and applied to your proposal.

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. *See, e.g.*, Interpretative 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).

It is clear that the proposed activities of the Partnership -- mortgage banking, advising, and finder activities -- are permissible for national banks. *See, e.g.*, 12 U.S.C. § 24(Seventh) (ability of national banks to generally make loans); 12 U.S.C. § 371 (ability of national banks to make, arrange, purchase or sell loans secured by liens on interests in real estate); Interpretative Letter No. 741, *reprinted in* [Current Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 81-105 (August 19, 1996) (permitting a national bank to conduct finder activities through an automobile database); Interpretative Letter No. 389, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L.Rep. (CCH) ¶ 85,613 (July 7, 1987) (allowing an operating subsidiary of a national bank to engage in real estate lending and real estate investment advisory activities); Interpretative Letter No. 238, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,402 (February 9, 1982) (national banks may make recommendations regarding the sale of property and provide financial consulting services). Indeed, each of the activities described in your application is accompanied by a citation to authority in 12 C.F.R. § 5.34(e), Interpretative Letter No. 271, *supra*, Interpretative Letter No. 387, *supra*, or Interpretative Ruling § 7.1002. Therefore, the proposed activities are part of, or incidental to, the business of banking, and 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.*

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,

but for as long as the bank has an ownership interest. This standard may be met in different ways, depending upon the type of entity in which the investment is made.

Ordinarily, in the absence of agreement otherwise, each partner in a general partnership has equal rights in the management and conduct of the partnership business, regardless of the level of "ownership." Uniform Partnership Act § 401(f)(1994). In addition, partners can allocate control among themselves through a partnership agreement. *Id*. § 103(a). Such agreements commonly require a unanimous vote on matters deemed to be fundamental, thus giving each partner a veto power. Therefore, when a national bank invests (through an operating subsidiary) in a general partnership, the OCC requires that the bank be able to exercise a veto power over the activities of the partnership, or be able to dispose of its interest. *See, e.g.*, Interpretative Letter No. 625, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993). This ensures that the bank will not become involved in impermissible activities.

The terms of the partnership agreement will enable the Bank, through FUMIS, to limit the Partnership to activities that are permissible for national banks. FUMIS will have the right to veto any proposed activities that it considers to be impermissible for national banks. In addition, a majority vote of the management committee is required for certain business decisions and the approval of a majority-in-interest of the partners is required for certain fundamental changes to the Partnership so that FUMIS, in effect, has veto power with respect to management committee and Partnership decisions. Finally, FUMIS has the ability to dissolve the Partnership pursuant to the partnership agreement.[8] Thus, 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 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. Normally, this is not a concern when a national bank invests in a limited liability company. As a legal matter, investors in a North Carolina LLC will not incur liability with respect to the liabilities or obligations of the LLC solely by reason of being a member or manager of the LLC -- even if they actively participate in the management or control of the business. See N.C. GEN. STAT. §§ 57c-3-30(a)(1993).

[8] The Company may be dissolved upon the written demand of any partner owning more than a 20% interest if such written demand is made within 120 days after the parties to the dispute have terminated the required mediation without reaching a settlement or other resolution.

National banks are not permitted to be partners in general partnerships due to the potential unlimited liability for the acts of other partners within the scope of the partnerships. *Merchants National Bank v. Wehrmann*, 202 U.S. 295 (1906). However, the OCC permits operating subsidiaries of national banks to enter into general partnerships that engage in bank-permissible activities because the corporate veil of the subsidiary corporation or LLC protects the bank from the potentially open-ended exposure associated with a direct partnership investment. Interpretative Letter No. 289, *reprinted in* [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,453 (May 15, 1984). Such is the case here. An LLC is an unincorporated business entity established under state law which provides its members with limited liability and allows them to participate actively in the entity's management. It confers on the owner-members the limited liability possessed by shareholders in a corporation, but the LLC may be treated as a partnership for federal tax purposes.

In addition, the OCC's Office of the Chief Accountant has advised that the appropriate accounting treatment for the investment in the Partnership would be to report it as an unconsolidated subsidiary under the equity method of accounting. Under this method, losses recognized by the investor will not exceed the amount of its investment (including extensions of credit or guarantees, if any) shown on the investor's books. *See generally* Accounting Principles Board, Op. 18, ¶ 19 (1971).

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure 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 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". See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972). 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. *See, e.g.*, Interpretative Letter No. 697, *supra*; Interpretative Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); Interpretative Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretative Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); Interpretative Letter No. 380, *supra*.

First Union is currently engaged in mortgage banking, advising, and finder activities, and will continue to actively participate in these lines of business together with TJM. The Bank

wishes to expand into a new market area, without making a full commitment of its resources, through the formation of the Partnership. First Union believes that by combining its existing resources, personnel, and expertise with TJM it will become a more effective competitor. TJM will offer nearly two decades of experience, a pool of potential customers, and extensive contacts with institutional lenders while the Bank and its affiliates will provide excess servicing, back office, and other support capacities.

The fact that the Bank will be a fifty percent owner of the Partnership with TJM is evidence of its intention to remain actively involved in these lines of business. The management and control of the Partnership will be vested in a committee and the Bank will hold two of the four seats on this committee. Far from being a passive or speculative investment, the subsidiary's fifty percent ownership interest will enable First Union to continue to be an active provider of mortgage banking and related services.

For these reasons, the proposed investment is convenient and useful to the Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

B. Partnership Issues

Some features of the Partnership, such as its activities and the Bank's veto power, have already been touched upon in discussing other issues. Certain other points about the Partnership should also be briefly mentioned. Since the OCC considers a general partnership to be an activity of the partner operating subsidiary, and since we reserve the right to supervise and examine operating subsidiaries under 12 C.F.R. § 5.34(d)(3), the Office requires that it have the right to supervise and examine general partnerships involving operating subsidiaries. *See, e.g.*,Interpretative Letter No. 625, *supra*; Interpretative Letter No. 381, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,605 (May 5, 1987). Counsel for the Bank has represented that the OCC will have the right to supervise and examine the Partnership.

The OCC has not required any minimum ownership level when operating subsidiaries participate in general partnerships. A search of our precedents will reveal a wide range of equity levels, including minority interests. *See, e.g.*, Letter of Vernon E. Fasbender, Director for Analysis, Southeastern District (December 6, 1990) (bank operating subsidiary to own 60 percent of partnership); Interpretative Letter No. 369, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,539 (September 25, 1986) (51 percent); Interpretative Letter No. 625, *supra* (50 percent); Interpretative Letter No. 381, *supra* (33 1/3 percent). A 50 percent ownership interest in the Partnership is therefore permissible.

CONCLUSION

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that First Union may establish an Operating Subsidiary

organized as an LLC which will make a 50 percent non-controlling investment in a general partnership in the manner and as described herein, subject to the following conditions:

(1) FUMIS and the Partnership will engage only in activities that are part of, or incidental to, the business of banking;

(2) the Bank, through FUMIS, will have veto power over any activities and major decisions of the Partnership that are inconsistent with condition number one, or will withdraw from the Partnership in the event it engages in an activity that is inconsistent with condition number one;

(3) the Bank will account for the investment in the Company under the equity method of accounting; and

(4) FUMIS and the Partnership 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.

If you have any questions, please contact Richard Erb, Licensing Manager, Multinational Banking at (202) 874-4610 or Robert Sihler, Senior Bank Structure Analyst, Bank Organization and Structure at (202) 874-5060.

Sincerely,

/s/

Julie L. Williams
Chief Counsel