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Comptroller of the Currency  
Administrator of National Banks

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Washington, DC 20219

November 24, 1998

**Conditional Approval #293**  
**December 1998**

John Eilering  
President  
Mount Prospect National Bank  
50 North Main Street  
Mount Prospect, Illinois 60056

Re: Application by Mount Prospect National Bank to Establish an Operating Subsidiary to  
Make a Noncontrolling Investment in Northwest Suburban Mortgage, L.L.C.  
Application Control Number: 98-CE-08-0031

Dear Mr. Eilering:

This is in response to the application by Mount Prospect National Bank, Mount Prospect, Illinois ("Bank"), to establish a wholly owned operating subsidiary, MPNB, Inc. ("Operating Subsidiary"), for the purpose of acquiring a one-half, non-controlling equity interest in Northwest Suburban Mortgage, L.L.C. ("NSM").<sup>1</sup> NSM will engage in the business of residential mortgage brokerage. Based upon the representations and commitments made by the Bank in its notice, as described herein, we approve the Bank's establishment of the operating subsidiary to engage in the proposed activity, subject to certain conditions as specified in this letter.

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<sup>1</sup>Because the activities of NSM, the company in which MPNB, Inc. will acquire an interest, are activities that qualify for after-the-fact notice pursuant to 12 C.F.R. § 5.34(e)(2)(ii)(L), the Bank initially filed an after-the-fact notice of its establishment of MPNB, Inc. However, the OCC views the act of acquiring a noncontrolling interest in an entity as an activity subject to review, and such activity does not qualify for the after-the-fact notice process. Thus, a national bank that intends to acquire a noncontrolling interest in an entity through an operating subsidiary must submit an operating subsidiary application and a filing fee to the OCC in accordance with the procedures set forth at 12 C.F.R. § 5.34(e)(1)(i), even where the proposed activities of the entity qualify for the after-the fact notice or expedited review process.

## **I. Proposal**

The Bank established the Operating Subsidiary for the purpose of acquiring a 50% ownership interest in NSM, an Illinois limited liability company. Community Lender Services, L.L.C. (“CLS”), an unaffiliated Illinois limited liability company, will own the remaining 50% of NSM. NSM will engage in residential mortgage brokerage activities. These brokerage activities include processing loan applications, underwriting, finding lenders to fund mortgage loans, and providing loan closing services. Loan underwriting, processing and closing services will be conducted on behalf of NSM by Main Street Home Mortgage Corporation (Main Street”) pursuant to a written contract. Originated loans will be pre-sold and generally funded at closing by third-party lenders, although the Bank and Main Street may, on occasion, fund mortgage loans for their own portfolios. NSM will lease space in Bank’s main office lobby and operate from that location.

The Operating Agreement provides that NSM will operate as a mortgage broker and in doing so, will engage only in activities which are legally permissible for national banks.<sup>2</sup> The Operating Agreement also grants the Operating Subsidiary the authority to veto any activity that is impermissible for a national bank, or to withdraw from or dissolve NSM in the event the company engages in such impermissible activity. Under the terms of NSM’s Operating Agreement, the day-to-day business and affairs of NSM will be managed and controlled by a Manager, although the Operating Subsidiary is granted exclusive authority over the marketing and promotion of NSM’s products and services. Amendments to the Operating Agreement require the approval of all of the members of NSM.

## **II. Analysis**

A national bank may invest in an operating subsidiary if the parent bank owns more than 50 percent of the voting interest in the subsidiary, or if it controls the subsidiary and no other party controls more than 50 percent of the voting interest. 12 C.F.R. § 5.34(d). Since the Bank will own 100 percent of the voting stock of the Operating Subsidiary, this requirement is satisfied.

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<sup>2</sup>At this time, the Bank and its affiliates do not act as agent in the sales of insurance or engage in finders activity with respect to insurance sales by third parties, and the Bank is not seeking approval for NSM to engage in such activities at this time. The Bank has represented that it will file an application to perform a new activity in an existing operating subsidiary, pursuant to 12 C.F.R. § 5.34(e), prior to NSM engaging in any insurance sales or insurance finders activity.

National bank operating subsidiaries may engage in activities that are part of, or incidental to, the business of banking. *Id.* In this case, the Operating Subsidiary's activity will be the holding of a 50-percent equity investment in NSM. According to the NSM Operating Agreement, the day-to-day affairs of NSM will be controlled and managed by the Manager. Certain designated acts must receive the prior approval of all members. The initial Manager, an officer of CLS, is designated in the Operating Agreement. The affirmative vote of members holding a majority of all of the percentage interests in NSM is required to fill a vacancy in the Manager position or to increase the number of Managers. Therefore, the Bank and the Operating Subsidiary will not control NSM.

#### A. Non-controlling Equity Investments

Ownership of a non-controlling equity investment is a permissible activity for a national bank or its operating subsidiary if the investment satisfies a four-part test, derived from OCC precedents. *See generally* Interpretive Letter No. 697, [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-012 (November 15, 1995). These are:

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.
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 from the investment.
3. The bank's loss exposure must be limited, for both legal and accounting purposes, and the bank must not have open-ended liability for the obligations of the enterprise.
4. The investment must be convenient and useful to the bank in carrying out its banking business, and not a mere passive investment unrelated to that business.

As discussed below, the Bank's proposal satisfies all four of these requirements.

- 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.*

NSM will engage in residential mortgage loan brokerage activities, *i.e.*, processing loan applications, underwriting, finding lenders to fund mortgage loans, and providing loan closing services. It is clear that these mortgage brokerage activities are permissible for national banks. National banks are specifically authorized by 12 U.S.C. § 371 to make, arrange, purchase, and sell loans or extensions of credit secured by liens on interests in real estate. The OCC previously approved national bank participation in entities which would engage in origination,

acquisition, servicing, and reselling of loans secured by real estate mortgages. See OCC Interpretive Letter No. 669 [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,617 (October 14, 1994). See also Conditional Approval No. 189 (December 15, 1995) (bank may establish an operating subsidiary that would own 50% of a limited liability company to provide residential mortgage services to customers of the bank).

Accordingly, the activities in which NSM will engage are permissible for national banks or their operating subsidiaries, 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 from the investment.*

The activities of an enterprise in which a national bank invests must be part of, or incidental to, the business of banking both initially and for as long as the bank has an ownership interest. Therefore, the OCC requires that the investing bank must be able to either prevent the enterprise from engaging in impermissible activities, or withdraw its investment.

In the present case, the Operating Agreement provides that NSM shall engage only in activities that are legally permissible for national banks. The Operating Agreement also grants to the Operating Subsidiary the right to veto any activity of NSM that is impermissible for national banks or to withdraw from or dissolve NSM in the event it engages in an activity impermissible for national banks. Moreover, the Operating Agreement cannot be amended without the unanimous vote of the NSM members.

Accordingly, the second standard is met.

*3. The bank's loss exposure must be limited for both legal and accounting purposes, 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 a national bank's investment not expose it to unlimited liability.

In the present case, the Bank's risk of loss will be limited by both the corporate veil of the Operating Subsidiary and by Illinois law, which provides that a member of an Illinois limited liability company is not personally liable for the company's debts, obligations, or other liabilities solely by reason of being a member. See 805 Ill. Comp. Stat. § 180/10-10 (Michie Cum. Supp. 1998). The Operating Agreement provides that Members shall not have any personal liability for any debts, obligations, liabilities or losses of NSM beyond the Member's

contributed capital. In addition, the Operating Agreement provides that members will not be required to make any additional capital contributions without the written consent of all members. Thus, no additional capital contributions could be required without the consent of the Operating Subsidiary.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure for accounting purposes, the OCC has previously noted that the appropriate accounting treatment for a bank's 20-50 percent ownership share of investment in an entity is to report it as an unconsolidated entity under the equity method of accounting.<sup>3</sup> Under this method, unless the bank has guaranteed any of the liabilities of the entity or has assumed other financial obligations of 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).

The Bank, through the Operating Subsidiary, will have a 50 percent ownership interest in NSM. You have represented that the Bank intends to treat this investment as an unconsolidated investment under the equity method of accounting, consistent with prior OCC approvals.

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 banking business, and not a mere passive investment unrelated to that 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." *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 intended to make it clear that section 16 did not authorize speculative investments in stock. Therefore, a national bank's investment in an enterprise or entity must also satisfy the requirement that it have a beneficial connection to the bank's business, *i.e.*, be convenient or useful to the investing bank's business activities, not a mere passive investment unrelated to the institution's banking business.

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<sup>3</sup>See Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-007 (Nov. 1, 1995), which discusses in more detail the appropriate accounting treatment for a national bank's minority investment in a limited liability company.

This requirement is satisfied here. NSM will provide the Bank with an additional venue in which to offer mortgage loan products and services to existing and prospective customers.<sup>4</sup> Thus, the Bank's investment in NSM, through the Operating Subsidiary, will be convenient and useful to the Bank in carrying out its business, and will not be a mere passive investment. Thus, the fourth standard is satisfied.

### **III. Conclusion**

Based upon the information that you have provided, and for the reasons set forth above, the OCC finds that the Bank may continue to hold, through the Operating Subsidiary, a 50 percent, non-controlling equity interest in NSM. Accordingly, the OCC approves the Bank's establishment of the operating subsidiary to engage in the proposed activity, subject to the following conditions:

1. NSM will engage only in activities that are part of, or incidental to, the business of banking.
2. The Bank, through the Operating Subsidiary, will have veto power over any activities of NSM that are inconsistent with Condition 1, or will withdraw from NSM in the event it engages in an activity inconsistent with Condition 1.
3. The Bank will account for its investment in NSM under the equity method of accounting.
4. NSM 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.

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<sup>4</sup>Generally, the Bank does not make or hold first mortgage loans. The Bank had been referring customers that request first mortgage loans to other mortgage lenders.

If you have any further questions, you may contact Carolina Ledesma, Licensing Analyst, at (312) 360-8867, Beverly Evans, Senior Licensing Analyst at (202) 874-5060, or Christopher Sablich, Senior Attorney, at (312) 360-8805.

Sincerely,

/s/

Raymond Natter  
Acting Chief Counsel