Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

August 17, 1999

Conditional Approval #324
September 1999

Mr. Daniel P. Cooney
Senior Vice President and Associate General Counsel
The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

Re: Application by The First National Bank of Chicago and Mercantile Bank National Association to each hold noncontrolling interests in a Limited Liability Company through de novo operating subsidiaries.
Application Control No. 1999-ML-08-0004, 1999-MW-08-0002.

Dear Mr. Cooney:

This is in response to the operating subsidiary application ("Application") submitted by The First National Bank of Chicago, Chicago, Illinois ("FNBC"), and Mercantile Bank National Association, St. Louis, Missouri ("Mercantile") (collectively "Banks"), pursuant to 12 C.F. R. § 5.34(e)(1). The Banks propose to establish operating subsidiaries to own membership interests in a limited liability company, Anexsys ("LLC"), and thereby engage in various cash management, electronic payment, and data processing services. The Banks will hold their interests in the LLC through operating subsidiaries. Each operating subsidiary will be wholly owned by each bank. For the reasons discussed below, the application is approved, subject to the conditions set forth herein.

A. Background

The LLC was formed by the Banks in 1995. The LLC's principal activity at that time was the provision of various cash management and data processing services to the Banks in connection with FNBC's appointment by the United States Department of the Treasury as the Treasury's financial agent for the electronic federal tax payment system ("EFTPS"). EFTPS is a cash management and data processing system that permits taxpayers to remit their taxes to the Treasury electronically and requires FNBC to furnish electronically to the Treasury various information with respect to taxes paid through the EFTPS.

The LLC has expanded beyond EFTPS to provide additional services also involving cash management, data processing, electronic payment, and information reporting. Through the proposed restructuring, the LLC is proposing to engage in additional opportunities to provide data processing,

cash management, and payment processing services to governmental entities, both state and federal.[1] Specifically, the LLC has recently begun to offer back office support for the Army and Air Force Exchange Service Internet Payments System Deferred Payment Plan ("AAFES"). AAFES is an electronic payment and transaction processing service, including related data processing and information reporting services. The LLC's role in AAFES involves bill payment operations, payment processing, accounts receivable handling, and funds transfer services. In addition, the LLC has proposed to engage in an electronic global cash concentration and information reporting system. This system would comprise cash management and funds transfer services, and related data processing and information reporting services, i.e., the collecting, transcribing, processing, analyzing, and storing of banking, financial or related economic data.[2]

B. 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. 12 C.F.R. § 5.34. In a variety of circumstances, the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a noncontrolling interest in an enterprise.[3] The OCC has concluded that national banks are legally permitted to make a noncontrolling investment in a company provided four criteria or standards are met.[4] These standards, which have been distilled from our previous decisions in the area of permissible noncontrolling investments for national banks and their subsidiaries, 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 its investment.*
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> (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.*

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[1] Banks have indicated that the purpose of this restructuring is to increase the tax efficiency of the joint venture.
In addition, as part of the restructuring by the LLC, Banks propose to transfer their 50% ownership interests in the LLC to de novo subsidiaries of Banks, so that the LLC is 50% owned by a direct subsidiary of FNBC and 50% owned by a direct subsidiary of Mercantile.

[2] It is our understanding that Banks plan to apply to the OCC to engage in additional activities for the LLC. The OCC will consider these activities when proposed and reserves the right to require divestiture or termination of the activities should they be determined to be impermissible for national banks.

[3] *See, e.g.*, OCC Conditional Approval Letter No. 219 (July, 15, 1996).

[4] *See* Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995), and OCC Interpretive Letter No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995).

(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.*

We conclude, as discussed below, that Banks' proposed reorganization of membership interests in the LLC satisfies these four criteria.

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

OCC precedents on non-controlling ownership have recognized that the enterprise in which a national bank takes an equity interest must confine its activities to those that are part of, or incidental to, the business of banking. Banks represent that the LLC will engage in cash management, data processing, electronic payment, and financial information reporting services through EFTPS, AAFES, and other vehicles, as described above.

As previously stated, EFTPS is a cash management and data processing system which permits taxpayers to remit their taxes to the Treasury electronically and requires FNBC to furnish electronically to the Treasury various information with respect to taxes paid through the EFTPS. The LLC's role in AAFES involves bill payment operations, payment processing, accounts receivable handling, and funds transfer services. The LLC's proposed electronic global cash concentration and information reporting system would involve cash management and funds transfer services, and related financial and economic data processing and information reporting services. These activities, as described by the LLC, are well established as part of the business of banking and permissible for national banks under 12 U.S.C. § 24 (Seventh).[5]

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[5] *See* OCC Interpretive Letter No. 731, *reprinted in* [1995-96 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81,048 (July 1, 1996) (national banks may initiate and process payments on behalf of a public authority); OCC Interpretive Letter No. 732, *reprinted in* [1995-96 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81,049 (May 10, 1996) (national bank may design and develop a network for the processing of accounts receivable); and OCC Interpretive Letter No. 419, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,643 (February 16, 1988) (national banks may use automated data processing to provide accounts receivable services). *See also* Interpretive Letter No. 757 *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-121 (August 26, 1996); 12 C.F.R. § 5.24(d)(2)(iii) (the OCC has long held that cash management services are part of the business of banking); OCC Interpretive Ruling 7.1019, Furnishing of products and services by electronic means and facilities, 61 Fed. Reg. 4849, 4865 (1996) (12 C.F.R. 7.1019) (permits national banks to provide permissible services by electronic means).

In addition, OCC has permitted a national bank to participate in a communications link between subscribers and their banks and with each other. Interpretive Letter No. 346, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,516 (July 31, 1985). The OCC also has approved electronic data interchange services for financial information. Interpretive Letter No. 653, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (Dec. 22, 1994) (informational and payments interface). National banks may use automated data processing to provide billing services and accounts receivable services for itself and others, Interpretive Letter No. 419, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,643 (Feb. 16, 1988), and engage in data processing related to funds transfer and cash management, *id*. (funds transfer); Interpretive Letter No. 611, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449 (Nov. 23, 1992) (cash management, funds transfer).

Accordingly, the activities in which the LLC will engage are part of, or incidental to, the business of banking. Thus, the first standard is satisfied.

2. The banks must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw their investment

This is an obvious corollary to the first standard. It is not sufficient that the entity's activities are permissible at the time a bank initially acquires its interest; they must also remain permissible for as long as the bank retains an ownership interest.

The limited liability company operating agreement ("Agreement"), under which the LLC is formed, contains provisions to ensure that the LLC will engage only in activities that are permitted for national banks and their subsidiaries. In particular, the Agreement provides that the LLC may engage only in activities which are legally permissible for a national bank. The Agreement further provides that with the unanimous approval of the members, the business of the LLC may be expended or revised; provided, that any member which is a national bank shall have the authority to veto or withdraw from the company in the event the LLC engages in activities that are otherwise not permissible for national banks. Moreover, the Agreement itself provides that it can only be amended with the unanimous written consent of the members.

Accordingly, 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 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 bank's investment not expose it to unlimited liability.

With respect to the third standard, Banks' loss exposure is limited, and Banks do not have open-ended liability for the obligations of the LLC. Banks' risk of loss will be limited by both the corporate veil of the operating subsidiary and by Illinois law. As a legal matter, investors in a Illinois limited liability company do 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. Ill. Ann. Stat. ch. 805, para. 10-10a (Smith-Hurd 1996). This law provides that the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort or otherwise, are solely the debts, obligations, and liabilities of the limited liability company unless the articles of organization of the limited liability company provide otherwise and the member has consented in writing to be so liable. The Operating Agreement organizing the LLC contains no such provision. Thus, the Bank's

loss exposure for the liabilities of the LLC will be limited by statute and by the Agreement establishing the LLC.

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 or investment in a corporate entity is to report it as an unconsolidated entity under the equity method of accounting. The Banks have advised the OCC that the accounting treatment for each of their 50 percent investments in the LLC is under the equity method of accounting. Under the equity method of accounting, unless either 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. Thus, Banks' losses from an accounting perspective would be limited to the amount invested by their operating subsidiaries in the LLC and Banks will not have any open-ended liability for the obligations of the LLC.

Accordingly, for legal and accounting purposes, the Banks' potential loss exposure, through Banks' operating subsidiaries, should be limited to the amount of Banks' indirect investment in the LLC. Since that exposure will be quantifiable and controllable, 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 must also satisfy the requirement that the investment have a beneficial connection to the bank's business, *i.e.*, be convenient or useful to the investing bank's business activities, and not constitute 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."[6] 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.[7]

In this instance, the proposed share ownership by Banks' is not merely evidence of a passive relationship, but is rather an effective and useful tool for allowing the banks to carry out their

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[6] *See Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972).

[7] *See, e.g.*, Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988).

responsibilities as financial and fiscal agent of the federal and local governments in connection with EFTPS and other existing or similar operations. Through the LLC, Banks will attempt to penetrate emerging markets in the provision of cash management, electronic payment, and financial information processing. In particular, the LLC's back office support for services for EFTPS, AAFES, and other similar services will allow Banks to compete for providing cash management and funds transfer services for government agencies. Entering these markets will enhance and diversify Banks' respective revenue opportunities. In addition, the Banks' investment in the LLC will be convenient and useful to Banks in allowing them to provide additional services to their retail customers, as well as helping Banks to gain additional expertise in the provision of electronic banking services, in general, and electronic payment and data processing, in particular. Thus, the investment is not a mere passive investment unrelated to Banks' banking business.

Accordingly, the fourth standard is satisfied.

C. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Banks applications to establish operating subsidiaries to invest in the LLC, are approved subject to the conditions:

1. The LLC may engage only in activities that are part of, or incidental to, the business of banking;

2. The Banks, through their operating subsidiaries, will have veto power over any activities of the LLC that are inconsistent with Condition 1, or will withdraw from the LLC in the event they engage in an activity inconsistent with Condition 1.

3. The Banks will account for their investment in the LLC under the equity method of accounting; and

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

The conditions of this approval are "condition[s] 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. As such, the conditions are enforceable under 12 U.S.C. § 1818.

If you have any questions regarding this decision, please contact John W. Graetz, Licensing Expert (Financial Analyst), in Bank Organization and Structure at (202) 874-5060, or John Soboeiro, Senior Attorney, Bank Activities and Structure at (202) 874-5300.

Sincerely,

/s/

Julie L. Williams
Chief Counsel