



Office of the Comptroller of the Currency

Interpretive Letter #737, Part 1

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E. Jay Finkel Esq.
Porter, Wright, Morris & Arthur
1233 20th Street, N.W.
Washington, DC 20036-2395

Re: Huntington National Bank, Columbus, Ohio -- Acquisition of Minority Interest in a Limited Liability Company Providing Stored Value Systems

Dear Mr. Finkel:

This responds to your letter of June 14, 1996, requesting confirmation that The Huntington National Bank, Columbus, Ohio ("Bank") may lawfully acquire and hold a minority interest in a joint venture to be formed as a for-profit Delaware limited liability company (the "LLC") with Battelle Memorial Institute, Columbus, Ohio ("Battelle") and the Student Loan Marketing Association, Washington, D.C. ("Sallie Mae").<NOTE: Initial membership interests will be 33-1/3 percent for each of the members. []> The LLC will develop, market, deliver and maintain stored value and information systems for universities, hospitals, business centers, theme parks, military installations, and other self-contained geographic locations (hereinafter: "System Customers"). The LLC's systems will use a smart card technology.<NOTE: A "smart card" is a plastic card with an embedded integrated circuit that looks like a credit card. A smart card is essentially a mini-computer that can store both data and programs. Depending on the capacity of the integrated circuit, the smart card may hold only limited information, or may have the capability of performing more complex computing functions. For stored value smart cards, an electronic device is used to load (add) or deduct value stored on the computer chip.> Based on the information and representations provided and for the reasons set forth below, I conclude that the proposed investment is permissible for a national bank.

A. The Proposal

The systems to be developed and supported by the LLC will serve two functions. The first function is a stored value system enabling cardholders to make cashless payments to System Customers and participating merchants. The second function is an information system for retrieving and exchanging data on the smart card; System Customers will use the cards with their data and systems for such institutional purposes as security access to buildings and computer systems, student meal plans, health care plan monitoring, and customer loyalty tracking in retail stores and supermarkets. The LLC proposes to test a prototype system in a pilot program that will be conducted with Ohio Dominican College ("ODC") this Fall. The specific role of the LLC in these two functions is described below.

1. Role of LLC in Stored Value Functions

The primary function of the LLC in the stored value systems will be to provide collection, processing and record keeping services for stored value transactions. The LLC will not itself hold the stored value funds nor be the stored value obligor. Instead, the funds from the sale of stored value will be held by and in the name of a bank or other entity agreed upon by the LLC and the System Customer, and that entity will be financially responsible for the stored value (hereinafter: the "issuer"). In the ODC pilot, the Bank will be the holder of funds and the obligor on the stored value. <NOTE: The Bank's request pertains only to the permissibility of its investment in the LLC. Thus, this letter does not address the permissibility of the activities of the Bank in the ODC pilot program. At this time, the precise role of the Bank in stored value systems is undetermined and many points of structure and process are still under development. Moreover, it is likely that the Bank will make changes in its role and functions based upon its experience with the ODC pilot. Thus, at this stage, the Bank's activities in stored value systems are not yet ripe for a formal opinion by the OCC and no such opinion has been requested. However, the OCC will review and monitor the Bank's activities in developing and operating the pilot program. > The LLC will not in the ODC pilot or in any other future system act as the issuer of the stored value and, thus, that value will in no way depend upon the financial soundness of the LLC. <NOTE: The Bank states that the maximum level of stored value that can be loaded on its System cards at any one time will initially be set at \$50 and that no plans exist for a higher level. Under the proposed amendment to Regulation E, 12 C.F.R. 205, stored value cards (like those proposed by Bank) with a maximum load of \$100 or less will be exempt from the requirements of the Regulation, including initial disclosures. 61 Fed. Reg. 19696 (May 2, 1996). However, as will be discussed, the LLC will ensure that certain disclosures are made to cardholders. The Bank has not yet determined whether the stored value in the ODC pilot will be covered by Federal deposit insurance. See Federal Deposit Insurance Corporation General Counsel Opinion No. 8, 61 Fed. Reg. 40494 (August 2, 1996). >

The LLC will arrange to have the cards produced and properly programmed for the System Customer. <NOTE: The cards will be produced by an outside card fulfillment company that currently produces various types of cards for banks. Additionally, some card production will be done locally to replace lost, stolen or damaged cards. The production, transit, storage and utilization of card stock will be in accordance with established security procedures. For cards with ATM or point of sale ("POS") functionality, the required information will be provided by Bank.> The LLC will sell the cards to the System Customer (and, perhaps, the issuer) who will distribute the cards to cardholders. <NOTAE: The System Customer will provide cardholders written disclosures complying with applicable laws and regulations either as part of the cardholder agreement given when the card is issued or on the card itself. Even if applicable law requires no disclosures, the LLC will generally require the System Customer to disclose fundamental contract terms to the cardholder, such as the identity of the stored value issuer, cardholder liability for unauthorized use or lost or stolen cards, phone numbers or addresses to use for problems with the card, expiration dates for the card, and other basic terms.> In the ODC pilot, two parties will enter agreements with cardholders regarding the cards: ODC for college-provided functions and Bank for Bank-provided functions. This will probably also be true with other future Service Customers. The LLC itself will have no direct contractual relationship with the cardholder; the LLC's contractual relations will be with the System Customer and the Bank or other stored value issuer. The names of the System Customer and the Bank (or other issuer) will appear on the cards.

The LLC will also have functions regarding the loading of stored value on the cards. All load transactions will be done at on-line cash revalue stations or kiosks that will be secure devices to protect any cash they receive as a result of cash-to-card load transactions. Two types of cards will be offered initially: (i) a card that can be loaded only by cash inserted in a "cash revalue station" ("CRS"); and (ii) a card that can be loaded either by cash inserted in a CRS or by an electronic funds transfer from an account with the Bank using a "kiosk." <NOTE: With the second type of card, the cardholder would also be required to open a bank account at the Bank. The LLC will not be involved in opening bank accounts. Regulation E will apply to transactions where a cardholder transfers funds from a bank account to load stored value on a card. > The LLC will own and maintain the CRS and the kiosks. Both types of devices will be on-line to the LLC so the

LLC can authenticate the card at the time of any load transaction and upgrade it with any new functionality.<NOTE:

The cards will be protected by available encryption technology. The system will have multiple levels of security which reduce the risk of counterfeiting. [

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].> The LLC will continuously monitor all on-line CRS and kiosks to determine the status of the device.

When value is loaded by a CRS, the LLC will be responsible for collecting the cash from the machines and forwarding the appropriate amount of funds to the Bank (or other value issuer) with the related information so the issuer can adjust its records. <NOTE: The Bank anticipates that in the ODC pilot it will, as stored value issuer, deposit funds representing the proceeds from sale of stored value into an interest-free general liability pooled account. However, the precise details of this aspect of the program are still being developed. > When value is loaded from a Bank account using a kiosk, the transaction will be handled by the LLC's platform [

]. The LLC's platform receives data from the kiosk, authenticates the transaction, then electronically forwards the transaction to an outside third party POS processor. The third party processor then electronically forwards the transaction through the settlement network to the Bank (or other issuer).

Finally, the LLC will provide support services for merchants accepting the cards for stored value purchase transactions. <NOTE: It is contemplated that where the cardholder maintains a deposit account with the Bank, the smart cards may also function as an ATM/POS card for that account. [

].> In the payment function, the LLC will contract directly with merchants who agree to honor the card as participants in the stored value system. The LLC will provide processing and settlement services to merchants participating in the stored value function of the card. <NOTE: Cards that are also Bank ATM/POS cards could also be used to make purchases using the POS function instead of the stored value function, and the POS function would settle through the existing POS arrangements with Bank.> [

]. The Bank expects that it (or another issuer) will also be a party to the merchant contracts as the funding bank, since the LLC will not hold the stored value pooled account or be liable for payments to merchants.

The LLC will provide the following specific products and services to participating merchants in order to facilitate the processing and settlement of transactions: (1) smart card readers to be used when the stored value cards are presented by cardholders for purchase transactions with the merchant; [Hardware and software that enable Merchants to store transaction data and transmit it to the LLC.]

Once the LLC's platform receives the merchant transaction data, the LLC will issue automated clearing house transactions that will debit the stored value pooled account at the Bank (or other issuer) and credit the merchant's account at the merchant's bank with the amount of the transactions being processed.

Finally, the LLC will provide certain auditing and record keeping functions relating to the stored value transactions. The system's transactions will be auditable and the LLC will keep records of transactions. The LLC will provide the Bank (or other issuer) with periodic reports so the issuer can reconcile the total balance in the stored value pool account [

].> The LLC will also maintain information that can be used to audit individual card transactions. <NOTE: [

[]. The LLC will archive all records of all stored value transactions and has no immediate plans to dispose of the archives.

2. Role of the LLC in Information Related Functions

The LLC will have a very limited role with respect to the information related functions that will mostly be provided and supported by the Service Customer. In the ODC pilot, the smart card will serve as an identification card, building access control, library card, ODC computer network access, and meal plan control. These functions will *not* involve any manipulation or processing of data by or through the LLC platform. The LLC's role with respect to these functions will be limited to two general activities: First, the LLC will replace the card readers of ODC's existing systems with card readers that will, upon insertion of a smart card, emulate the magnetic stripe access signals required for activation of ODC's existing systems. Second, the LLC will see that the smart cards are programed so that the new card readers can read and use them with ODC's existing data systems. ODC's data processing system will do all data processing on the information related functions. The LLC will play a similar limited role with respect to information related functions in any future systems it develops for other System Customers.

B. Legal Analysis

Your letter raises the issue of the authority of a national bank to make a non-controlling investment in a limited liability company. In a variety of circumstances the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a minority interest in an enterprise. The enterprise might be a limited partnership, a corporation, or in more recent examples, a limited liability company. In two recent interpretive letters, the OCC concluded that national banks are legally permitted to make a minority investment in an LLC provided four criteria or standards are met. *See* Interpretive Letters No. 692 (Nov. 1, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) 81,007, and No. 694 (Dec. 13, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) 81,009.

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 enterprise in which the bank invests 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; (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. For the reasons discussed, I conclude that the proposed investment by Bank in the LLC satisfies these four criteria.

1. The activities of the LLC must be limited to activities that are part of or incidental to the business of banking.

The National Bank Act, in relevant part, provides that national banks shall have the power:

[t]o exercise ... all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes ...

12 U.S.C. 24(Seventh).

The Supreme Court has held that the powers clause of 12 U.S.C. 24(Seventh) is a broad grant of power to

engage in the business of banking, including but not limited to the enumerated powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 115 S.Ct. 810 (1995) ("*VALIC*"). Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank v. State Bank*, 77 U.S. 604, 648 (1871) (certification of checks has grown out of the business needs of the country and involves no greater risk than a bank giving a certificate of deposit); *M&M Leasing Corp. v. Seattle First Nat. Bank*, 563 F.2d 1377, 1382-83 (9th Cir. 1977), *cert. denied*, 436 U.S. 987 (1978) (personal property lease financing is "functionally interchangeable" with the express power to loan money on personal property); *American Insurance Association v. Clarke*, 865 F.2d 278, 282 (D.C. Cir. 1988) (standby credits to insure municipal bonds is "functionally equivalent" to the issuance of a standby letter of credit). Further, as established by the Supreme Court in *VALIC*, national banks are authorized to engage in an activity if it is incidental to the performance of the five enumerated powers in section 24(Seventh) *or* if it is incidental to the performance of an activity that is part of the business of banking.

It is well established that a national bank may use electronic or data processing technology to perform services expressly or incidentally authorized to national banks. *See* OCC Interpretive Letter No. 677 *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,625. As noted in the recently revised OCC Interpretive Ruling recognizing this authority, a national bank may "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide or deliver." *See* 12 C.F.R. 7.1019 (1996). The functions of the LLC in the proposed smart card systems are part of or incidental to the business of banking.