



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #318
August 1999

July 21, 1999

Mr. Thomas C. Clark, III
Maynard, Cooper & Gale, P.C.
1901 Sixth Avenue North
Suite 2400 AmSouth/Harbert Plaza
Birmingham, Alabama 35203-2618

Re: Application of National Bank of Commerce of Birmingham, N.A., Birmingham, Alabama, to participate through an operating subsidiary in a joint venture conducting residential mortgage lending services.
Application Control No. 99-SE-08-0011

Dear Mr. Clark:

This is in response to your application dated April 1, 1999, to John Stein, Licensing Manager, Southeastern District, on behalf of the National Bank of Commerce of Birmingham, N.A., Birmingham, Alabama ("the Bank"), by which the Bank applied pursuant to 12 C.F.R. § 5.34 (e)(1)(i)(B) to establish an operating subsidiary and to participate through the operating subsidiary in a joint venture ("the Joint Venture") conducting residential mortgage lending services. For the reasons set forth below, we approve, subject to certain conditions, the establishment of such operating subsidiary by the Bank and the Bank's investment in the Joint Venture through the operating subsidiary, in the manner described herein.

Background

As described in the Bank's notification, the Bank intends to participate in the Joint Venture through a wholly-owned operating subsidiary to be established by the Bank and called NBC Joint Ventures, Inc., ("NBC"). The Joint Venture will be organized as a limited liability company under Alabama law, and will be called Mortgage First of the South, L.L.C. ("the LLC" or "the Joint Venture LLC"). The party participating in the Joint Venture with NBC will be the First Real Estate Corporation of Alabama, Birmingham, Alabama ("FREC" or "the Co-Venturer"), an established real estate broker engaged in the residential real estate brokerage

business.¹ NBC and the Co-Venturer will each own a fifty percent interest in the Joint Venture.² NBC and the Co-Venturer will provide adequate capital for the Joint Venture to commence and continue its operations. In some instances, the Bank or another lender may provide operating loans to the Joint Venture on arms-length terms as negotiated between the lender and the Joint Venture. NBC and/or the Bank may also enter into a services agreement with the Joint Venture to provide administrative services to the Joint Venture on an arms-length basis.

The Joint Venture's proposed activities will include all activities permissible to national banks in connection with the origination, processing, servicing, and sale of residential mortgage loans. Initially, marketing of the Joint Venture's mortgage lending services will focus primarily on the customers of the Co-Venturer. The Bank expects to purchase a minority of the mortgage loans originated by the Joint Venture. The Joint Venture will lease space for its main offices from a third party and will house its sales force in the offices of the Co-Venturer. All loans will be disbursed and funded at offices of settlement attorneys, not at origination or sales offices.³ In

¹ FREC is a residential mortgage brokerage firm that was founded in 1973 and is one of Alabama's largest real estate companies, with approximately 600 agents. In 1995, two real estate agents brought a lawsuit against FREC, claiming discriminatory lending practices. Specifically, they alleged that FREC was steering minority buyers only to minority neighborhoods. On May 14, 1998, a Consent Decree was entered in the United States District Court for the Northern District of Alabama (Southern Division) with FREC, the U.S. Department of Justice, two real estate agents, and the Fair Housing Center of Northern Alabama, which required FREC to pay a fine to the plaintiff agents, establish a fund to compensate any consumers who were impacted by any prior fair lending violations and establish a fund for anti-discrimination training for its agents. In March 1997, FREC was purchased by its current owners, Henry Ray (who owns 60%) and Wyatt Haskell (who owns 40%). Because the alleged fair lending violations and lawsuit occurred prior to the purchase of the company by its current management, Messrs. Ray and Haskell, and because FREC has remained in compliance with the terms of the Consent Decree, the fact that FREC will be the Co-Venturer does not raise supervisory concerns at this time.

² Section 5.1 of the Draft Operating Agreement of the Joint Venture LLC provides that the business and affairs of the LLC will be managed by a six member Management Committee, three of which shall be chosen by each member, NBC and FREC. Each member of the Management Committee will have one vote and any action requires an affirmative vote of a majority of the total number of members of the Management Committee.

³ Although the Joint Venture will be making loans, locations of the Joint Venture will not be branches of the Bank within the meaning of the McFadden Act, at 12 U.S.C. § 36(j). The operations of an entity in which a national bank has a non-controlling interest are not ordinarily attributed to the bank for branching purposes. See Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23,

any event, the Bank represents that the mortgage lending activities of the Joint Venture will comply with the OCC's Interpretive Rulings regarding the originating and making of loans at banking and other banking offices. See 12 C.F.R. §§ 7.1003, 7.1004, and 7.1005.⁴ The Bank further represents that any extension of credit from the Bank to the Joint Venture will comply with the lending limits and loans-to-one borrower rules set forth in 12 U.S.C. § 84 and OCC's regulations, 12 C.F.R. Part 32.⁵

In addition, the arrangements between the Co-Venturer and the Joint Venture in conducting mortgage lending services will likely constitute "controlled business arrangements" ("CBAs") as that term is defined under the Real Estate Settlement Procedures Act of 1974, as amended ("RESPA"). Such activities will fully comply with RESPA and all applicable regulations implemented thereunder, including the CBA rules. In order to monitor compliance with RESPA, the Joint Venture and its participants will observe the following procedures: (i) the Joint Venture will provide a CBA Disclosure Statement to customers as required by RESPA; (ii) customers will not be required to use any particular provider of settlement services; and (iii) the only thing of value that participants in the Joint Venture will receive will be returns on their ownership interests and other payments permissible under RESPA. The Joint Venture may contract-out certain administrative functions to third parties, including the Bank. The Bank may provide the Joint Venture with access to its software programs and hardware pursuant to a services agreement. However, all of these agreements will be structured so that all activities will fully comply with RESPA and all applicable regulations, including the CBA rules.

Discussion

1996) (national bank to take minority equity interest in mortgage banking company). In the present case, corporate structure considerations reinforce this conclusion. The Joint Venture LLC will be an autonomous business, not part of the Bank, with its own customers and offices that are not located in the Bank's branches. Although NBC may have representatives on the Joint Venture's board of directors, no NBC employees will participate in the day-to-day operations of the Joint Venture. In addition, the Joint Venture LLC will be treated as an entity distinct from the Bank for supervisory purposes.

⁴ Specifically, no borrower will receive the proceeds of a loan from the Bank's funds at a facility that is established by the Bank. In addition, funding for all loans made by the Joint Venture will be from the Joint Venture's own funds, and at least half of the Joint Venture's funding will come from sources other than the Bank. Furthermore, any transactions between NBC and the Joint Venture will be on an arms-length basis.

⁵ For the purposes of 12 U.S.C. §§ 371c and 371c-1, NBC and the Joint Venture are subsidiaries, and not affiliates of the Bank, and thus not subject to the restrictions of either statute. See 12 U.S.C. §§ 371c(b)(1)(E), (2)(A). Nevertheless, the Bank has committed that the Bank and its subsidiaries will adhere to the comparative transaction standard set forth in § 371c-1.

The Office of the Comptroller of the Currency (“the OCC”) has traditionally recognized the authority of national banks to organize and perform any of their lawful activities in a reasonable and convenient manner not prohibited by law. A national bank may engage in activities that are part of or incidental to the business of banking under 12 U.S.C. §24(Seventh) by means of an operating subsidiary. 12 C.F.R. §5.34(d)(1).⁶

The Bank’s proposal to hold a fifty percent interest in the Joint Venture through NBC raises the issue of the authority of a national bank to make a non-controlling investment in a joint venture structured as a limited liability company through a wholly-owned operating subsidiary of the Bank. In a variety of circumstances the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a non-controlling interest in an enterprise. The enterprise might be a limited partnership, a corporation, or a limited liability company.⁷ In various interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in a limited liability company, provided four criteria or standards are met.⁸ These standards, which have been distilled from our previous decisions in the area of permissible non-controlling investments for national banks and their subsidiaries 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;
- (2) The bank must be able to prevent the entity or 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 *that bank’s* banking business.

⁶ A national bank, through its operating subsidiary, has also been authorized to be a general partner. Similarly, the OCC has permitted national banks, directly or indirectly through operating subsidiaries, to be limited partners in partnerships.

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.

⁸ See, e.g., Interpretive Letter No. 778 (March 20, 1997), *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-205 and Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007.

Each of these factors is discussed below and applied to your proposal with respect to non-controlling investments in joint ventures.

- (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.*

The Joint Venture's proposed activities -- mortgage banking and related activities -- are part of, and incidental to, the business of banking under 12 U.S.C. §§ 24(Seventh) and 371 and, thus, permissible for entities in which investments are to be made. It is well established that national banks have the authority to make, arrange, purchase, sell or service loans or extensions of credit secured by liens on or interests in real estate.⁹ The OCC has also approved non-controlling investments and participations by national banks in joint ventures structured as LLCs engaged in mortgage lending banking and related activities.¹⁰

Accordingly, 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 initially purchases stock, but

⁹ See, e.g., Interpretive Letter No. 711, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-026 (February 23, 1996) (national bank to take minority equity interest in mortgage banking company); Interpretive Letter No. 694, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-009 (December 13, 1995) (national bank permitted to take a non-controlling, minority interest in LLC that purchases secured home improvement loans and sells them in the secondary market); Interpretive Letter No. 668, *reprinted in* [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) (October 14, 1994) (national bank permitted 50% ownership of LLC which acquires and services mortgage loans); Interpretive Letter No. 645, *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,554 (April 29, 1994) (national bank can take a controlling interest in a LLC to originate and service residential real estate mortgage loans); Interpretive Letter No. 423, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,647 (April 11, 1988) (national bank operating subsidiary authorized to act as managing general partner of a limited partnership investing in real estate mortgage-related assets).

¹⁰ See, e.g., Interpretive Letter No. 853, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-310 (February 16, 1999) (national bank may make a direct, non-controlling, minority equity investment in a joint venture structured as a limited liability company with an unaffiliated mortgage company); Conditional Approval No. 243 (May 9, 1997) (unpublished) (national bank may participate through one or more operating subsidiaries in joint ventures conducting residential mortgage lending services).

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. One way to assure continuing compliance with this standard is for the constituent documents of a joint venture, whether articles of incorporation, bylaws or by contractual provisions in a partnership or other agreement, to limit its activities to those that are part of, or incidental to, the business of banking or to provide an effective veto over activities of the entity.¹¹

You have represented that safeguards will be in place with respect to the Joint Venture to ensure that it conducts only activities that are part of, or incidental to, the business of banking. For example, the constituent documents of the Joint Venture and the agreement with the Co-Venturer will provide (and draft documents provided at our request confirm) that (i) the Joint Venture may engage only in activities permissible to national banks or their operating subsidiaries, (ii) NBC has effective veto power (through supermajority voting rights or otherwise) over decisions regarding the activities of the Joint Venture and/or has the right to withdraw from the Joint Venture if the Joint Venture engages in any activity not permissible to national banks or their operating subsidiaries, and (iii) the Joint Venture is subject to OCC supervision, regulation and examination.¹² By these means, the Bank will be able to ensure that the Joint Venture conducts only activities that are part of, or incidental to, the business of banking, or that it may withdraw from the Joint Venture in the event that it is not able to prevent such activities from taking place.

Accordingly, the second standard is satisfied.

- (3) *The bank's loss exposure must be limited and the bank must not have open-ended liability for the obligations of the enterprise.*

A. *Loss exposure from a legal standpoint*

¹¹ See, e.g., Interpretive Letter No. 625, *reprinted in* [1993-1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993) (national bank operating subsidiary acting as one of two general partners, each of which had veto power over actions to be taken by the partnership).

¹² See, e.g., Sections 1.3 and 5.1 of the Draft Operating Agreement of the LLC. Section 1.3 provides that the LLC "...shall not under any circumstances have the power to do any act which is not permissible to national banks under the National Banking Act, 12 U.S.C. § 1 et seq., and all orders, rules and regulations promulgated thereunder; and all acts of the Company must be a part of, or incidental to, the general business of banking." Section 5.1 provides that in the event NBC determines that the LLC is, in effect, not complying with Section 1.3, NBC "shall have the right, exercisable in its sole and absolute discretion, to dissociate from the Company by voluntary act, and, at such time, [NBC] shall be entitled to a distribution in an amount equal to the fair value of its Units in the Company as of the date of such resignation."

A primary concern of the OCC is that national banks should not be subjected to undue risk, especially 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. Normally, this is not a concern when a national bank invests in a corporation, for shareholders are not liable for the debts of the corporation, provided proper corporate separateness is maintained.¹³ Similarly, investors in a LLC generally will not incur liability with respect to the liabilities or obligations of the LLC, the limit of liability generally is the amount of the investor's capital contributions to the LLC. As a legal matter, investors in an Alabama limited liability company will not incur liability with respect to liabilities or obligations of the limited liability company, even if they actively participate in the management of control of the limited liability company.¹⁴

Such is the case here. Legal safeguards will be in place with respect to the Joint Venture in order to protect the Bank from unlimited liability. You have represented that the constituent documents of the Joint Venture will ensure that the Bank will not be liable for the liabilities of the Co-Venturer or for the general liabilities of the Joint Venture beyond the amount of its investment in the Joint Venture.¹⁵ NBC will not become a general partner in any limited partnership. Similarly, the legal structure of the Joint Venture, i.e., as an LLC, will ensure that the Bank is shielded from unlimited liability with respect to the Joint Venture. NBC will adhere to corporate formalities and maintain its corporate existence separate from its affiliates and the Joint Venture. Under principles of corporate law, NBC's parent companies (including the Bank) will not be liable for the general liabilities of the Joint Venture. Moreover, under Alabama law governing LLCs, NBC will not be liable for the general liabilities of the Joint Venture beyond the extent of its fifty percent investment in the Joint Venture.

¹³ 1 William M. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 25 (perm. ed. rev. vol. 1990).

¹⁴ See ALA. CODE § 10-12-20 (1998). This section is not intended to relieve a member from liability arising out of the member's own acts or omissions to the extent such actions or omissions would be actionable, either in contract or in tort, against the member if the member were acting in an individual capacity. Therefore, with respect to his or her liability for the debts and obligations of the LLC, a member is analogous to a limited partner or a stockholder. *Id.*, Commentary.

¹⁵ Section 7.7 of the Draft Operating Agreement of the Joint Venture LLC provides: "No Member shall be liable under a judgment, decree or order of a court, or in any other manner for the Debts or any other obligations or liabilities of the Company. A Member shall be liable only to make its Capital Contributions and shall not be required to restore a deficit balance in its Capital Account or to lend any funds to the Company or, after its Capital Contributions have been made, to make any additional contributions, assessments or payments to the Company. No Member shall have any personal liability for the repayment of any Capital Contributions of any other Member."

The Bank's loss exposure for the liabilities of the Joint Venture, therefore, will be limited by law and constituent documents executed by the co-venturers.

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 of investment in a limited liability company is to report it on an unconsolidated basis. Under the equity method of accounting, unless the 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.¹⁶

As proposed, the Bank will have a fifty percent ownership interest in the Joint Venture LLC. The Bank will account for its investment in the LLC under the equity method.

Accordingly, for both legal and accounting purposes, the Bank's potential loss exposure should be limited to the amount of its investment. Because the Bank will not have open-ended liability for the liabilities of the Joint Venture and its potential liability 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 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".¹⁷ 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 only intended to make it clear that section 16 did not authorize speculative investments

¹⁶ See generally, Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock); See also Interpretive Letter No. 735, reprinted in [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-052 (July 15, 1996) (national bank's non-controlling minority interests -- due to supermajority voting provisions -- in LLCs to hold "other real estate owned" used equity method of accounting).

¹⁷ See *Arnold Tours, Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972).

in stock.¹⁸ Our precedents on bank non-controlling investments have indicated that the investment must be convenient and 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.¹⁹

The Bank's investment in the Joint Venture through NBC will be convenient and useful for the conduct of the Bank's banking business. The Joint Venture will provide NBC new market exposure through relationships with real estate brokers and their customers. Such exposure will enhance NBC's abilities to originate residential mortgage loans. The proposed activity is intimately related to the Bank's business of making loans and provides a convenient method for the conduct and expansion of such business. Arrangements such as the proposed Joint Venture are becoming commonplace in the mortgage industry and conducting its business in this manner will help the Bank compete more effectively in the marketplace. The investment is, therefore, "necessary" to the Bank's ability to efficiently and capably offer these mortgage lending services, to attract a broader customer base, and to compete more effectively. 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.

Accordingly, the fourth standard is satisfied.

Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that the Bank may establish an operating subsidiary, NBC, and through NBC, may participate without further notification to the OCC in the Joint Venture structured as a LLC to conduct residential mortgage lending services in the manner and as described herein, subject to the following conditions:

- (1) NBC, and the Joint Venture will engage only in activities that are part of, or incidental to, the business of banking;

¹⁸ See Interpretive Letter No. 697, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-012 (Nov. 15, 1995) (national bank's operating subsidiary to hold 25% interest and serve as a general partner in a partnership to own a trust company).

¹⁹ See, e.g., Interpretive Letter No. 697, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991) (national bank authorized to acquire nominal stockholding for membership in corporation of primary dealers in government securities); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988) (national bank permitted to buy Farmer Mac stock in nominal amounts); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988) (national bank permitted to invest in the Government Securities Clearing Corporation).

- (2) The Bank, through NBC, will have effective veto power over any activities and major decisions of the Joint Venture that is inconsistent with condition number one, or will withdraw from the Joint Venture in the event that it engages in any activity that is inconsistent with condition number one;
- (3) The Bank will account for its non-controlling investment in the Joint Venture under the equity method of accounting; and
- (4) NBC and the Joint Venture 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 and, as such, may be enforced in proceedings under applicable law.

This approval is granted based on a thorough review of all information available, including the representations and commitments made in the application and by Bank representatives.

Sincerely,

/s/

Julie L. Williams
Chief Counsel