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Comptroller of the Currency  
Administrator of National Banks

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Central District  
One Financial Place, Suite 2700  
440 South LaSalle St.  
Chicago, Illinois 60605-1073

Office of the District Counsel  
Voice (312) 360-8805  
Facsimile (312) 435-9632

December 14, 2005

**Interpretive Letter #1046**  
**January 2006**  
**12 USC 24(7)**

Dear [ ]:

This responds to your letter of November 15, 2005 requesting that the Office of the Comptroller of the Currency (“OCC”) confirm your belief that [ ] (“Bank”), may acquire a non-controlling interest in [ ] (“[ *LLC* ]”). For the reasons set forth below, the Bank may acquire and hold the interest in [ *LLC* ] in the manner and as described herein.

**A. Background**

The Bank proposes to purchase a 5.1% membership interest in [ *LLC* ]. The remaining membership interests will be acquired by other financial institutions and insurance companies. [ *LLC* ] is being formed for the purpose of financing [ ] (“Fund”), a venture capital fund of funds established pursuant to [ ] of the [ *State* ] Revised Code. The Fund is designed to promote the economic growth in [ *State* ] by investing in venture capital funds that commit to invest funds in qualified [ *State* ]-based companies. The Fund is not affiliated with the Bank.

[ *LLC* ] will provide the financing for the Fund by issuing bonds and lending those funds to the Fund. Neither the Bank nor [ *LLC* ] will make any equity investment in the Fund. [ *LLC* ] proposes to issue \$125 million of taxable bonds to institutional and other accredited investors, and then lend the proceeds from the bond issuance to the Fund. The bonds will be secured by a letter of credit, issued by another bank, in which the Bank and the other holders of [ *LLC* ] membership interests will participate in proportion to their membership interests (“Financing Syndicate”). [ *LLC* ] also proposes to enter into an arrangement with the

Financing Syndicate to hedge a portion of the interest rate risk in the bonds, and simultaneously enter into an identical interest rate hedge with the Fund to hedge the interest rate risk on [ *LLC* ]'s loan to the Fund. If [ *LLC* ] incurs a loss of principal or interest on its loan to the Fund, it will receive state tax credits equal to such losses, which will be passed through to the members of [ *LLC* ] in proportion to their ownership interests.

## **B. Analysis**

The OCC has concluded that it is lawful for a national bank to hold a noncontrolling investment in an entity or enterprise, such as a limited liability company, provided four criteria or standards are met.<sup>1</sup> 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 entity or enterprise 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 are impermissible for national banks 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.

Based upon the facts presented, the Bank's proposed investment in [ *LLC* ] satisfies these four standards.

- 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 (or otherwise authorized for a national bank).*

The proposed activities of [ *LLC* ] are legally permissible under 12 U.S.C. § 24(Seventh) as part of or incidental to the business of banking. National banks have express statutory authority to make loans.<sup>2</sup> National banks also have broad authority to borrow money and issue debt

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<sup>1</sup> See, e.g., 12 C.F.R. § 5.36(e); Conditional Approval Letter No. 568 (Dec. 31, 2002).

<sup>2</sup> 12 U.S.C. § 24(Seventh).

instruments.<sup>3</sup> Finally, the OCC has opined that hedging risks arising from permissible banking activities is an essential and integral part of those banking activities.<sup>4</sup> Thus, [ *LLC* ]'s proposed activities are permissible.

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.*

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 activities of [ *LLC* ] will be set forth in its operating agreement. Moreover, the operating agreement will permit the Bank to divest of its investment in [ *LLC* ] should it ever engage in any impermissible activities. The Bank has represented that it will divest of its interest in [ *LLC* ] if it were to engage in activities impermissible for a national bank. 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 the national bank's investment not expose it to unlimited liability.

[ *LLC* ] is a [ *State* ] limited liability company. As a legal matter, the members of a [ *State* ] limited liability company are not liable for the obligations or liabilities of the limited liability company solely by reason of being a member of the company.<sup>5</sup>

Thus, the Bank's loss exposure for the liabilities of [ *LLC* ] is limited.

- b. *Loss exposure from an accounting standpoint*

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<sup>3</sup> See Interpretive Letter No. 378 (March 24, 1987), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶85,602 (reviewing relevant case law). See also 12 C.F.R. §§ 3.100 (bank capital regulations); 5.47 (licensing procedures for issuance of subordinated debt); and 12 C.F.R. Part 16 (disclosure rules for offering of bank securities, including debt instruments).

<sup>4</sup> See OCC Interpretive Letter No. 892 (Sept. 13, 2000), reprinted in [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81-411.

<sup>5</sup> See Ohio Rev. Code Ann. § 1705.48 (West 1994).

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 less than 20 percent ownership share or investment in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of accounting. You have represented that the Bank will account for its ownership interest in the Company according to the cost method of accounting.

Therefore, for both legal and accounting purposes, the Bank's potential loss exposure arising from its investment in the [ *LLC* ] should be limited to the amount of those investments. 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. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment.

This requirement will be met here. The investment in [ *LLC* ] will allow the Bank to participate in the provision of financing to the Fund and support its role as a member of the Financing Syndicate.

Accordingly, the fourth standard is satisfied.

### **C. Conclusion**

Based upon a thorough review of the information you provided, including the representations and commitments made in your letter, and for the reasons discussed above, it is my opinion that the Bank may acquire a non-controlling equity investment in [ *LLC* ], subject to the following conditions:

- (1) [ *LLC* ] will engage only in activities that are permissible for a national bank;
- (2) The Bank will withdraw from [ *LLC* ] in the event that it engages in an activity that is inconsistent with condition (1);
- (3) The Bank will account for its investment in [ *LLC* ] under the equity or cost method of accounting; and
- (4) [ *LLC* ] will be subject to OCC supervision and examination, subject to the limitations and requirements of 12 U.S.C. §§ 1820a and 1831v.

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These conditions are conditions imposed in writing by the OCC in connection with this opinion letter stating that the Bank's investment in the Company is permissible under 12 U.S.C. § 24(Seventh). As such, these conditions may be enforced in proceedings under applicable law.

If you have any questions, please contact Senior Counsel Chris Sablich at (312) 360-8805.

Sincerely,

*/s/ Coreen S. Arnold*

Coreen S. Arnold  
District Counsel