



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Interpretive Letter #1077
February 2007
12 USC 24(7)

January 11, 2007

[*Bank1*]

[*Bank3*]

[*Bank2*]

[*Bank4*]

Subject: Non-controlling Equity Investments in [] .

Dear Mssrs. [], [], [], and []:

[*Bank1, City, State*]; [*Bank2, City, State*]; [*Bank3, City, State*]; and [*Bank4, City, State*] (“Banks”) have each made a noncontrolling investment in a new company known as [] (“Co.”). [] was organized by [] (“Co.”) as a [*State*] limited liability company to sell fraud prevention, identity verification, credential validation, and payment/deposit risk services to financial institutions, credit card issuers, check acceptance companies, brokerage firms, mutual fund companies, retailers, government agencies, and others. The Banks seek an opinion from the OCC verifying the permissibility of these non-controlling investments. We conclude that the investments are permissible under 12 U.S.C. § 24(Seventh) for the reasons described below.

Background

[] is a new company that consolidates the systems, operations, personnel and assets of [Co.]’s [] (“*A*”) and [] (“*B*”) units, both established providers of fraud prevention, identity verification, credential validation and payment/deposit risk services. Each national bank has invested approximately \$[] million in [], now holds 18% of []’

membership interests, and has one representative on []' Management Committee. [*Co.*] has contributed the assets of [*A*] and [*B*] to [], also holds 18% of the new company's membership interests, and has one Management Committee representative.¹ []' President also has a seat on the company's Management Committee.

Each national bank has certified the following:

- It is well-capitalized and well-managed.
- It will account for its investment in [] under the equity or cost method of accounting.
- Its loss exposure is limited, as a legal and accounting matter, and it does not have open-ended liability for []' obligations.
- [] has agreed that it is subject to OCC supervision and examination, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act, 12 U.S.C. § 1831v, and section 115 of the Gramm-Leach-Bliley Act, 12 U.S.C. § 1820a.

[]' services will include the following:

- IDENTITY CHEK _(sm) - Detects invalid, inconsistent and unusual elements of an individual's identity.
- Internal Fraud Prevention Service - Helps financial services organizations identify employee applicants that have been terminated by another financial services organization for committing or attempting to commit certain fraudulent acts.
- Known Fraud Screening – Helps participating financial institutions establishing or reviewing an account involving a consumer. Provides access to information about consumers involved in known or attempted fraud against their financial institutions.
- Account Risk Screening - Helps assess the risk associated with an applicant by screening a prospective customer's identity against a database containing individuals who have caused losses at financial institutions.
- Age & ID Verification - Used by merchants to prevent unauthorized access to age sensitive goods and services.
- ID Validation - Used by financial institutions and government agencies to detect altered and counterfeit identification.
- DEPOSIT CHEK _(sm) - An industry utility for financial institutions seeking to mitigate deposit losses by sharing current account status and transaction level information.
- Deposit Risk Service² - Reduces exposure to check losses at the point-of-deposit with real-time notification of account and item-level information using check reader or onsite server.
- Payment Risk Service - Reduces exposure to check and payment losses at the point-of-presentment by providing notification of high-risk negative account and item-level information.
- Remittance Risk Service - Reduces exposure to check payment losses for credit card issuers and other remittance payment processors.

¹[*Bank*], [*City, State*], a state nonmember bank organized under the laws of [*State*], holds 10% of []' membership interests, and one seat on its Management Committee.

² This service, as well as the Payment Risk Service, are being combined and renamed "Payment Chek _(sm)."

- Credential Verification - Allows for a driver's license or other similar credential to be verified as authentic.

[] will utilize [A]' established national data bases of information on accounts, transactions and identities, which will be updated daily. [A]' deposit data base consists of non-public information contributed by numerous financial institutions. [Co.] has estimated that, as of June 2005, this deposit base covered 90% of all open and active U.S. transaction accounts. [A]' identity verification data base is comprised both of public and nonpublic information. [A] has developed a set of operating rules and procedures, which will continue to govern []' operations that strictly limit use of these data bases to specified fraud/loss prevention purposes.

Permissibility of the non-controlling investment

The OCC traditionally has 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.³ In a number of interpretive letters, the OCC has concluded that national banks are legally permitted to make a non-controlling investment in an enterprise provided four criteria or standards are met. 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 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).
- (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.
- (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 Banks' investment in [] 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.

³ See, e.g., Interpretive Letter No. 943, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-468 (July 24, 2002); Interpretive Letter No. 890, *reprinted in* [2000-2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-409 (May 15, 2000); Interpretive Letter No. 854, *reprinted in* [1998-1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-311 (Feb. 25, 1999); Interpretive Letter No. 692, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (Nov. 1, 1995).

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....

The Supreme Court has held that this powers clause of 12 U.S.C. § 24(Seventh) is a broad grant of authority to engage in the business of banking, which is not limited to the five enumerated powers. Further, national banks are authorized to engage in an activity if it is incidental to the performance of the enumerated powers in the statute or if it is incidental to the performance of an activity that is part of the business of banking.⁴

[]’ activities, in essence, allow financial institutions, credit card issuers, check acceptance companies, brokerage firms, mutual fund companies, retailers, government agencies, and others to access and use national data bases owned by [], with detailed information on U.S. transaction accounts and identity verification attributes. Access and use of this information is provided in a framework that assists those entities in addressing fraud prevention, identity verification, credential validation and payment/deposit risk issues. These activities fall within the scope of data processing and related activities that are permissible for national banks, and OCC has held such activities, whether performed for the bank itself or for others, to be part of the business of banking, so long as the data is banking, financial, or economic data. 12 C.F.R. § 7.5006. This rule states that:

It is part of the business of banking under 12 U.S.C. § 24(Seventh) for a national bank to provide data processing, and data transmission services, facilities (including equipment, technology, and personnel), data bases, advice and access to such services, facilities, data bases and advice, for itself and for others, where the data is banking, financial, or economic data, and other types of data if the derivative or resultant product is banking, financial, or economic data. For this purpose, economic data includes anything of value in banking and financial decisions.

12 CFR § 7.5006(a).

The rule codifies OCC interpretations confirming that a national bank may collect, process, transcribe, analyze, and store banking, financial, and economic data for itself and others as part of the business of banking.⁵ The OCC has confirmed that “the business of banking includes the distribution of data, generation of reports, and keeping of records related to data derived from or aggregating banking or financial data.”⁶ Also, “what matters under 7.5006(a) is the nature of the

⁴ *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 215 (1995).

⁵ See, e.g., OCC Conditional Approval No. 289 (Oct. 2, 1998); OCC Interpretive Letter No. 805, reprinted in [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,252 (Oct. 9, 1997).

⁶ OCC Conditional Approval No. 361 at n. 10 (March 3, 2000).

data being processed, not whether the entity receiving the processing also receives other banking services from the bank.”⁷ Therefore, the recipient does not have to be a bank customer.

OCC interpretations also confirm the permissibility of the activities of []. For example, OCC has approved national bank non-controlling equity investments in companies that provide payment authorization and check verification services,⁸ and/or that verify signatures and identities.⁹ In fact, the OCC has concluded that identity verification services are a “core competence” of banks.¹⁰

In one case very similar to the current proposal, OCC approved a joint proposal by four national banks to make non-controlling equity investments in a company that provided, among other things, check verification and credit fraud detection services to financial institutions and merchants.¹¹ The check verification services were to be provided by [A], one of the predecessor companies of [], and the company also acquired a controlling interest in [A]. This company also acquired a noncontrolling interest in the credit fraud detection service provider.

The check verification services involved in that case, as here, relied upon [A]’s national database, comprised of information contributed by thousands of financial institutions, to warn of possible check returns and enable appropriate “funds hold” decisions.¹² Similarly, the proposed credit fraud detection services involved, as here, use of a broad national database.¹³ The OCC noted, in connection with the databases involved, that it “has long held that national banks may collect, transcribe, process, analyze, store, and make available to others, banking, financial, or other economic data,” and concluded that all of the data involved there was of this nature.¹⁴

Fraud prevention systems and credential validation also have been approved for national banks by the OCC. For example, the OCC-approved investment by national banks in the EFT network described above also included card fraud detection services that offered to financial institutions and EFT networks, among other things, a nationwide electronic data base of debit card fraud information and a central data base of fraud information.¹⁵ In addition, credential validation has been approved by the OCC most specifically in connection

⁷ OCC Interpretive Letter No. 986 (Feb. 24, 2003).

⁸ OCC Interpretive Letter No. 890 (May 15, 2000).

⁹ OCC Interpretive Conditional Approval No. 339 (Nov. 16, 1999).

¹⁰ OCC Interpretive Letter No. 267 (Jan. 12, 1998); OCC Interpretive Letter No. 928 (Dec. 24, 2001).

¹¹ OCC Interpretive Letter No. 854 (Feb. 25, 1999).

¹² These decisions are based on an electronic verification of the checking account, which includes a positive verification of the account’s existence, and multiple other status codes such as account closed, insufficient funds, and others, to prevent the early release of uncollected funds.

¹³ The database was designed to (i) provide early warning to financial institutions and EFT networks of multiple-card counterfeit fraud; (ii) determine the dimensions of the fraud, distinguishing multiple-card incidents from single-card incidents and determining the magnitude of the exposure; (iii) identify suspect cards (both cards already used and cards in the perpetrator’s inventory), allowing action to be taken to contain losses; and (iv) provide a central data base of fraud information to support investigative efforts and fraud level monitoring and reporting.

¹⁴ OCC Interpretive Letter No. 267, *supra*.

¹⁵ OCC Interpretive Letter No. 854, *supra*.

with digital signature activity, which a national bank operating subsidiary would offer to any subscriber.¹⁶

We conclude that the services and activities of [] are within the scope of the business of banking and are permissible for national banks. 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.

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.

Each of the Banks has represented that []' activities will be conducted in accordance with the terms and conditions set forth in the OCC's regulations, rulings and other pronouncements regarding the activities in question and that [] will engage in no activity that is not permissible for national banks to conduct directly. To assure that this is, and remains, the case, the Banks hold four seats on []' Management Committee. Furthermore, []' Limited Liability Company Agreement includes a provision limiting the company's activities to those permissible for national banks. This provision cannot be amended without the unanimous consent of the Banks. 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. With respect to the third standard, the Banks loss exposure is limited, and the Banks do not have open-ended liability for the obligations of []. As a legal matter, investors in a [*State*] 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. [*State*] Code Ann. Tit. [], § [] (). Nor have the Banks agreed to be obligated "for any or all of the debts, obligations and liabilities" of [], as permitted by [*State*] law. [*State*] Code. Ann. Tit. [] § []. Thus, the Bank's loss exposure for the liabilities of [] will be limited by statute.

- (b) Loss exposure from an accounting standpoint.

In assessing a bank's exposure as an accounting matter, the OCC previously has noted that the appropriate accounting treatment for a bank's less than twenty percent interest in a corporate entity is to report it as an unconsolidated entity under the equity or cost method of

¹⁶ OCC Interpretive Letter No. 267, *supra*.

accounting. *See, e.g.*, Interpretive Letter No. 943, n. 9, *supra*. The Banks have represented that each will account for its investment in [] under the equity or cost method of accounting.

Therefore, for both legal and accounting purposes, the national banks' potential loss exposure arising from their investment in [] should be limited to the amount of their investment. Since that exposure will be both 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 that is not an operating subsidiary of the bank also must 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."¹⁷ OCC precedents on non-controlling investments by national banks 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.¹⁸

[]' services, which the Banks will continue to employ in their own operations, are not just convenient and useful, but essential to the Banks' business and to their safe and sound operation. No bank, and indeed few businesses, can operate safely today without access to credential and identity verification technology, and without the ability to quickly verify checks, credit cards, other payment items and identity credentials at point of presentment.

In addition, the Banks' investment in [] will facilitate and enhance their ability to conduct banking operations in additional ways. The Banks' stake in [] will allow them to influence and supervise the company's activities to ensure that they are aligned with the needs and responsibilities of the Banks.¹⁹ The Banks' investment will also provide them with a higher degree of access to []' expertise in fraud prevention, identity verification, credential validation, and payment/deposit risk services than they would as customers.²⁰ Such access will help the Banks gain a level of experience, which they may in the future leverage for their own

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

¹⁸ *See, e.g.*, Interpretive Letter No. 943, n. 9, *supra*; Interpretive Letter No. 875, *reprinted in* [1999-2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-369 (Oct. 31, 1999); Interpretive Letter No. 909, *supra* at 5; Interpretive Letter No. 890, n. 9, *supra*; Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (Feb. 13, 1991).

¹⁹ *See, e.g.*, Interpretive Letter No. 854 (Feb. 25, 1999) (national banks' noncontrolling investment in an EFT network will allow them to influence and supervise the services provided by each of the networks involved in the proposal.)

²⁰ *See, e.g.*, Interpretive Letter No. 897 (Oct. 23, 2000) (national bank's investment in a registered investment adviser will provide it access to the adviser's expertise in the management of growth-equity, technology and small cap investments, and private investment fund management.)

benefit.²¹ Also, making the investment in [] will allow the Banks to pool their resources rather than each having the expense of developing similar databases themselves.²² Finally, the Banks will be active Management Committee members, furthering the development of the relationship between [] and the Banks.²³

Therefore, the investment is not a mere passive investment unrelated to the national banks' business, and the fourth standard is satisfied.

Supervisory Issues

The foregoing analysis establishes that the activities performed by [] are part of the business of banking and so are within the activities authorized for national banks under 12 U.S.C. § 24(Seventh). However, [] also must have the systems and controls, and the general capacity, to conduct the activity in compliance with applicable law and in a safe and sound manner. Accordingly, as part of its supervision and examination of [], the OCC will evaluate []' risk measurement and management systems and controls to ensure that the activities are conducted in a safe and sound basis and in compliance with applicable law.

The Banks are aware of the risks [] poses with regard to the significant inherent legal, reputation and operational risk created by the nature of its business. Data is the primary asset of [], and it maintains a significant amount of sensitive information. Data breaches could have a significant impact on the Banks' reputation. In addition, sharing and using negative bank customer and employee information also creates inherent reputation and legal risk. [] will be governed by the same operating rules and procedures previously developed by [A] that strictly limit the use of the data bases to specified fraud/loss prevention purposes.

Conclusion

Based upon the information and representations provided, and for the reasons discussed above, it is my opinion that the Banks may retain their non-controlling equity investment in [], subject to the following conditions:

- (1) [] will engage only in activities that are permissible for a national bank;
- (2) National banks will divest their respective interests in [] in the event that [] engages in any activity that is inconsistent with condition (1);

²¹ See, e.g., Interpretive Letter No. 887 (April 30, 2000) (national bank's investment in a business trust established to purchase, own, and lease commercial aircraft will allow the bank to expand its business into personal property leasing and gain a level of experience which could be leveraged for its own benefit.)

²² See, e.g., Interpretive Letter No. 889 (April 24, 2000) (national banks' investment in a company that offers retail brokerage services, lending, and insurance-related services over the Internet will allow the banks to offer these services without having to incur the expense of development themselves.)

²³ See, e.g., Interpretive Letter No. 855 (Mar. 1, 1999) (national bank's investment in a corporation that provides stored value systems and services will create a symbiotic relationship with the corporation through which each will derive benefits from the other.)

(3) National banks will account for their respective investments in [] under the equity or cost method of accounting; and

(4) [] will be subject to OCC supervision and examination.

These conditions are conditions imposed in writing by the OCC in connection with the Banks' request for a determination by the OCC that their investment in [] is permissible under 12 U.S.C. § 24(Seventh). As such, these conditions may be enforced in proceedings under applicable law.

Sincerely,

/s/

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel