



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Conditional Approval #842
April 2008

March 13, 2008

Nancy M. Stiles, P.C.
Silver, Freedman & Taff, L.L.P.
3299 K Street, N.W., Suite 100
Washington, D.C. 20007

Re: Application by MB Financial Bank, N.A. to establish an operating subsidiary and to hold a limited equity investment in connection with its investment management activities
Application Control Number: 2008-WO-080001

Dear Ms. Stiles:

This responds to the application filed by MB Financial Bank, N.A., Chicago, Illinois (“Bank”), requesting approval to acquire an 80% interest in Cedar Hill Associates, Inc. Highland Park, Illinois (“Adviser”), a registered investment adviser, as an operating subsidiary of the Bank.¹ The Bank also has requested approval for the Adviser to hold limited equity interests in those funds for which Adviser will serve as investment manager. Based on the representations and commitments made by the Bank, the application is consistent with OCC precedent and, accordingly, is approved, subject to the conditions described herein.²

A. Background

The Adviser provides investment advisory and investment management services to its clients, which include high net worth individuals and their related interests, under advisory agreements that provide for discretionary investment and reinvestment of clients’ funds. The Adviser also establishes and manages proprietary private investment funds in the form of limited partnerships

¹ The Adviser is an Illinois corporation. Following the acquisition by the Bank, the Adviser will convert to a Delaware limited liability company.

² The OCC has previously concluded that a national bank’s operating subsidiary may hold limited interests in private investment funds for which the operating subsidiary serves as investment manager. *See, e.g.*, Conditional Approval No. 755 (Aug. 25, 2006); Conditional Approval No. 643 (June 16, 2004); and Conditional Approval No. 578 (Feb. 27, 2003).

and limited liability companies, in which its clients' funds are invested.³ Interests in the private investment funds are transferred in private placements exempt from registration under state and federal securities laws. The Adviser is the investment manager for and advises all of its proprietary private investment funds ("Funds"). All of the assets held by the Adviser's proprietary private investment funds are equity and debt securities (including both securities permissible for the Bank to own and securities not permissible for the Bank to own) in various forms, most often comprised of passive investments in other investment funds which are established by third parties unrelated to Adviser.⁴ These third party funds are not advised or managed by the Adviser.⁵ The Adviser also owns 100% of R Squared, Inc. ("General Partner"), an Illinois corporation, which serves as the general partner of several of the Funds.

The Adviser and the General Partner have made nominal capital contributions (\$100) to certain of the Funds. These capital contributions remain invested in those funds. The Adviser also receives performance-based compensation for its investment management services in the form of profit allocations in the Funds.⁶ These profit allocations will remain invested in certain of the Funds.⁷

The Bank represents that this type of performance compensation arrangement is intended to ensure that an investment manager earns its performance-based compensation based on the performance of the fund over the same horizon as the fund's investors, i.e., over the life of the fund, not on a year-to-year basis. The Bank believes structuring performance compensation in this manner will address investors' concerns that fund managers' interests be aligned as closely as possible with those of investors. The Bank represents that private investment funds routinely structure the investment adviser or manager's performance compensation in this manner.

The Bank also states that individuals or entities who invest in the Adviser's funds, which are taxed as partnerships, favor performance-based compensation for investment managers that is structured as profit allocations because of limits on the investors' ability to deduct fees and expenses under U.S. tax law. As a result, and as the OCC has previously recognized, it is

³ The Adviser also has established and manages private investment funds organized outside the United States. This letter does not address the permissibility of the Adviser's activities with respect to the foreign funds.

⁴ The assets in the proprietary private investment funds vary according to the individual fund investment goals and strategy. The Bank represents that the assets of these Funds do not include real estate or tangible personal property; however, it is possible that the third party funds in which these proprietary funds may invest could have those investments.

⁵ Because some of these other investment funds from time to time may include investments in commodity pools (futures contracts), GP is a registered commodity pool operator. The OCC has allowed national bank subsidiaries to act as commodity pool operators. *See* OCC Conditional Approval No. 139 (May 4, 1994); OCC Interpretive Letter No. 541 (February 6, 1991); and OCC Interpretive Letter No. 496 (December 18, 1989).

⁶ The Adviser and the General Partner may receive both administrative fees and performance-based compensation from the funds for their services. The administrative fee is typically a percentage of the assets of each fund. The performance-based compensation is typically a percentage of the profits of each fund above a certain hurdle rate.

⁷ The Bank represents that the performance-based compensation will be reflected as allocations to the Adviser's capital accounts in the funds and will be accounted for under the equity method of accounting.

industry practice for investment advisors and managers (whether owned by banks or not) to receive profit allocations in private investment funds as compensation for their advisory services in order to maximize tax efficiency for the investor clients.⁸

For these reasons, the Bank states that it would be significantly disadvantaged in competing for clients if the Adviser were unable to structure its performance-based compensation as profit allocations to its equity accounts in the funds and to retain those profit allocations in the funds.

The Bank represents that the Adviser's equity interests in the advised funds will be limited and will be held only for so long as the Adviser is providing investment management services to the funds.⁹ Other than the nominal initial investments, the Adviser will not make any additional out-of-pocket investments in the Funds or guarantee any liabilities of the Funds. In addition, the Bank has represented that the Adviser's maximum investment retained in a fund it advises will not exceed an amount equal to 2.5% of the total equity in the fund.¹⁰ The Bank also has represented that the Adviser's retained maximum aggregate investment in all funds it advises will not exceed an amount equal to 2.5% of the Bank's total risk based capital.¹¹

B. Discussion

Section 5.34(e) of the OCC's operating subsidiary regulation provides that "a national bank may conduct in an operating subsidiary activities that are permissible for a national bank to engage in directly either as part of, or incidental to, the business of banking, as determined by the OCC, or otherwise under other statutory authority"¹² The OCC has long held that a national bank may provide investment management services as part of the business of banking authorized under 12 U.S.C. § 24(Seventh) and pursuant to their fiduciary powers under 12 U.S.C. § 92a.¹³

⁸ See Conditional Approval No. 578, *supra*.

⁹ The Bank represents that under the governing instruments of any new private investment funds established by the Adviser, the Adviser will have the right to sell, redeem or otherwise dispose of its equity interests in the funds if it no longer serves as investment manager for the funds or if it is not in compliance with applicable investment limits.

¹⁰ The Adviser's investment in a fund includes any initial investments it has made and any performance based profit allocations it has received. The Bank also has represented that the Adviser will transfer any equity interests it receives in a Fund that would exceed the 2.5% investment limit to the Bank, and the Bank will immediately dividend the equity interests, either in cash or in kind, to its holding company, MB Financial, Inc., subject to any regulatory limits on the payment of dividends and any other applicable law.

¹¹ The Bank also represents that the Adviser's loss exposure from an accounting perspective is limited to the initial capital contribution made to certain funds and the amount of profit allocations the Adviser expects to receive as compensation. The Bank notes, however, that the Adviser or General Partner may have certain additional unanticipated costs, which are expected to be minimal, in connection with a liquidation of a fund.

¹² 12 C.F.R. § 5.34(e).

¹³ See *e.g.*, Interpretive Letter No. 851 (Dec. 8, 1999); Interpretive Letter No. 871 (Oct. 14, 1999); Conditional Approval No. 164 (Dec. 9, 1994); Interpretive Letter No. 648 (May 4, 1994); Interpretive Letter No. 622 (Apr. 9, 1993); and Interpretive Letter No. 403 (Dec. 9, 1987).

More recently, the OCC has concluded that an operating subsidiary may hold limited equity interests in private investment funds for which it serves as investment manager and that it may structure the performance based compensation it receives as profit allocations in advised funds where certain conditions were present. The OCC determined that holding such limited interests and structuring the payment of performance compensation in this manner are directly related to, and an integral part of, the subsidiary's activity of providing bank-permissible investment management and administrative services, and are therefore incidental to permissible investment advisory activities.

Consistent with the OCC's prior determinations, the Adviser will be engaged in the authorized activities of acting as an investment adviser to private investment funds and receiving compensation for such services in the form of fees and profit allocations in those funds.¹⁴ The Adviser's equity interests in the advised funds will be limited and will be held only for so long as the Adviser is providing investment management services to the funds. Accordingly, under the applicable legal framework and OCC precedent, the acquisition of the Adviser as an operating subsidiary of the Bank and the Adviser's holding of limited equity interests in the funds it advises is permissible, subject to the conditions set forth below.

C. Conclusion

Based on a review of the information you provided on behalf of the Bank, including the representations and commitments made in connection with the Bank's application, and for the reasons discussed above, we conclude that Bank may acquire the Adviser as an operating subsidiary and that the Adviser may engage in the investment management activities described, including holding limited interests in the Funds, subject to the conditions in this letter.

- a. The Bank shall adopt and implement an appropriate risk management process, acceptable to and within the timeframes set by the appropriate Supervisory Office, to monitor the described activities and any interests held by Adviser and General Partner in the Funds. The risk management process shall be comprehensive and shall include:
 - i. Adoption and implementation of a conflict of interest policy addressing all inherent conflicts associated with Adviser's and General Partner's activities and holdings of interests in the Funds;
 - ii. Adoption and implementation of risk management policies and procedures for monitoring the Adviser's and General Partner's activities and interests in the Funds and the risks associated with these interests, taking into account relevant factors noted in OCC guidance (e.g., OCC Banking Circular 277 (BC-277 - October 1993), Supplemental Guidance 1 to BC-277 (January 1999) and the Handbook for National Bank Examiners, *Risk Management of Financial Derivatives* (January 1997)); and

¹⁴ See, e.g., Conditional Approval No. 755, Conditional Approval No. 643, and Conditional Approval No. 578, *all supra*. The Adviser and the General Partner, a wholly owned subsidiary of the Adviser, also will act as general partners for the Funds. The OCC has held that a national bank's operating subsidiary may act as general partner of a limited partnership. See e.g. Corp. Decision No. 2000-07 (May 10, 2000); Conditional Approval No. 243 (May 9, 1997); and Interpretive Letter No. 411 (Jan. 20, 1988).

- iii. Establishment of an appropriate governance structure to oversee the Adviser's and General Partner's activities and interests in the Funds that would include obtaining periodic reports from the Adviser and General Partner on the investments in the Funds, including information on the Adviser's and General Partner's risk management policies and procedures.
- b. The Bank, through Adviser and General Partner, shall hold its interests in the Funds only when, and only for so long as, Adviser and General Partner, as applicable, are providing investment management services to the Funds.
- c. The Bank, through Adviser, General Partner and its other subsidiaries and affiliates as applicable, is subject to the restrictions and guidelines outlined in OCC Bulletin 2004-2, concerning the provision of financial support to investment funds advised by the Bank, its subsidiaries or affiliates.
- d. The Bank shall provide its Supervisory Office ten days notice before the Adviser or General Partner makes an investment in any new fund.
- e. The Bank shall ensure that the Adviser adopts and adheres to the following limits for the Adviser's investments in existing funds and any new funds that contain bank-ineligible assets:¹⁵
 - i. *Individual fund basis* – The Adviser's maximum investment in any fund it advises shall not exceed an amount equal to 2.5% of total equity in the fund.
 - ii. *Aggregate funds basis* – The Adviser's maximum aggregate investment in all such funds shall not exceed an amount equal to 2.5% of the Bank's total risk based capital.
 - iii. *Types of funds* – The Adviser shall not invest in funds it advises other than those that invest in securities and financial instruments, and the Adviser shall not invest in any fund that directly holds real estate or tangible personal property.
- f. For GAAP accounting purposes pursuant to Fin 46R, the Bank will not consolidate the Funds.
- g. The Funds shall constitute affiliates of the Bank and its subsidiaries and affiliates for purposes of Sections 23A and 23B of the Federal Reserve Act.
- h. The Bank shall make reports and other information readily available to OCC supervisory staff as necessary for the OCC to determine compliance with these conditions.

The conditions of this approval are conditions imposed in writing by the agency in connection with the granting of an 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.

This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the United States, any agency or entity of the United States, or any officer or employee of the United States, and do not affect the ability of the OCC to exercise its supervisory, regulatory

¹⁵ These investments would include any capital contributions made by the Adviser or General Partner and any performance based profit allocations received by the Adviser or General Partner that are retained in a Fund.

and examination authorities under applicable laws and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the United States.

If you have any questions concerning this letter, please contact Licensing Analyst Bruce Halper at (202) 874-5060.

Sincerely,

signed

Lawrence E. Beard
Deputy Comptroller, Licensing