



**Comptroller of the Currency
Administrator of National Banks**

Washington, DC 20219

**Conditional Approval #248
July 1997**

June 27, 1997

Mr. Robert L. Klivans
BankBoston, N.A.
Assistant General Counsel
100 Federal Street
Boston, Massachusetts 02106

Re: Notice of BankBoston, N.A., to Acquire and Hold Through an Operating Subsidiary, a 50 Percent Interest in a Limited Liability Company Engaging in Credit and Debit Card Transaction Processing Services to Merchant Businesses
Application Control Number 97-ML-08-0012

Dear Mr. Klivens:

This is in response to your May 14, 1997 letter on behalf of BankBoston, N.A., Boston, Massachusetts (“the Bank”) concerning a proposed investment by the Bank in a limited liability company through an existing operating subsidiary. The LLC will provide credit and debit card transaction processing services to merchant businesses, including commercial deposit and loan customers of the Bank and other subsidiaries of BankBoston Corporation. For the reasons given below, we conclude that the activity proposed on behalf of the LLC is permissible for national banks and their operating subsidiaries and is consistent with prior OCC opinions. Accordingly, the Bank may, through an operating subsidiary, hold a 50 percent interest in the LLC to engage in the proposed activities, subject to the conditions set forth herein.

A. Background

The Bank proposes to acquire and hold a non-controlling 50 percent interest in a Delaware limited liability company (“the LLC or “the Company”). The LLC will have two members, BayBanks Credit Corp. (“BBCC”) and First Data Merchant Services Corporation (“FDMS”) (collectively “the Members”). BBCC was formerly a wholly-owned subsidiary of BayBank, N.A. Following the recent merger of BayBank, N.A. into the Bank, BBCC is currently a wholly-owned subsidiary of the Bank. FDMS is an indirect, wholly-owned subsidiary of First Data Corporation and part of the First Data Card Services Group, a provider of card-based services to more than 1.8 million merchant outlets and 1,400 financial institutions around the

world. The LLC will be similar to other joint ventures in which FDMS participates with other U.S. banks through its “Merchant Bank Alliance “ program.

BBCC and FDMS will each contribute a combination of merchant contracts and other assets used to provide merchant processing services in return for their respective initial interests in the Company. In order to increase FDMS’ equity interest to 50 percent and decrease BBCC’s equity interest to 50 percent, FDMS will immediately purchase a portion of BBCC’s interest in the Company in exchange for (1) \$1,500,000 in immediately available funds and (2) a promissory note which will provide for aggregate payments of principal and interest (at a rate of 8 percent per annum) of (a) \$1,000,000 on the second anniversary of the Company’s formation and (b) \$500,000 on the third anniversary of the Company’s formation.

The primary goal of the Company will be to provide credit and debit card processing products and services to merchants, including commercial loan and deposit customers of the Bank. The LLC will be staffed by employees of the Bank, BBCC and FDMS. These employees will generate new merchant processing arrangements, both directly and through referrals by Bank and BBCC employees to FDMS employees. Such employees will also provide customer service support for the Company’s products and services, with the Bank’s and BBCC’s employees retaining front-line customer service responsibility for certain merchants who are also Bank loan and deposit customers. The Company will enter into a long-term, exclusive processing arrangement with FDMS, under which FDMS will provide back-shop processing services to the Company at a more competitive pricing than is currently available to BBCC (due to the size of the Company’s combined merchant portfolio).

The LLC will be managed by a Management Committee comprised of four managers. BBCC and FDMS will each have the right to designate two managers to the Management Committee. Key decisions, including the sale, lease, transfer, encumbrance or other disposition of more than \$100,000 of Company assets, merger or consolidation involving the LLC, voluntary liquidation, dissolution or termination of the Company, any split, combination or reclassification of membership interests, declaration, setting aside or payment of distributions, admission of new members, and any initial registered public offering of any equity interests in the Company, require the unanimous consent of all Members. All other decisions regarding the operations of the Company will be made by a majority of the Management Committee.

The Bank states that the proposed LLC Agreement (“the Agreement”) will provide that: (1) the Company will not engage in any activities in which a national banking association is not legally permitted to engage; and (2) the Company will not undertake any new activities without the approval of a majority of the Management Committee. The Bank also states that “[t]hese provisions assure that the Company will not engage in any activity that is not permissible for a national bank or its subsidiaries, and that the Bank effectively will have a veto power over any impermissible activity as long as it continues as a member of the Company.” Letter at p.3.

B. Discussion

The Bank's plan to purchase and hold, through an operating subsidiary, a 50 percent interest in the Company raises the issue of the authority of a national bank to make a non-controlling, investment in a limited liability company.¹ A number of recent OCC Interpretive Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a non-controlling interest in a limited liability company. *See, e.g.*, Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,007, and No. 694 (December 13, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,009.² These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.³ They 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 from 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,

¹ The OCC recently revised its rules governing national bank corporate activities and transactions in 12 C.F.R. Part 5. A national bank must have a controlling investment in the subsidiary, usually more than 50 percent of the voting (or similar type of controlling) interest. A national bank may own less than 50 percent of the voting interest in the subsidiary, so long as the national bank "controls" the subsidiary, and no other party controls more than 50 percent. 12 C.F.R. § 5.34(d)(2), 61 *Fed. Reg.* 60342, 60374 (1996). Here, the LLC would not be considered an operating subsidiary of the Bank as BankBoston will not "control" the LLC.

² The OCC has also permitted national banks to make a non-controlling investment in an enterprise other than an LLC, provided the investment satisfies these four standards. *See e.g.*, Interpretive Letter No. 732, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81-049 (May 10, 1996); Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,012; and Interpretive Letter No. 705 (October 25, 1995), *reprinted in* [Current] Fed. Banking L. Rep. ¶ 81,020;

³ *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.

(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.

Each of these factors is discussed below and applied to your proposal.

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.*

Our precedents on non-controlling stock ownership have recognized that the enterprise in which the bank takes an equity interest must confine its activities to those that are part of or incidental to the business of banking. *See e.g.*, Interpretive Letter No. 380 (December 29, 1986), *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services); Letter of Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is a “fundamental part of the basic business of banking”, an equity investment in a corporation operating such a network is permissible.)

The LLC will provide merchant credit and debit card processing services. It is clear that merchant processing activities are permissible for national banks, whether conducted directly or through operating subsidiaries, under 12 U.S.C. § 24(Seventh).⁴ *See e.g.*, Interpretive Letter No. 689 (August 9, 1995), [Current] Fed. Banking L. Rep. (CCH) ¶ 81-004; Interpretive Letter No. 720, (January 26, 1996), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,035; Banking Bulletin 92-94, Merchant Processing (May 5, 1992). Therefore, this 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. 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 first acquires its ownership, but for as long as the bank has an ownership interest.

Several provisions in the proposed LLC Agreement (“Agreement”), copies of which were submitted to the OCC, are designed to satisfy the requirement that BBCC will participate as an owner of the LLC only so long as the Companies’ activities remain permissible for national banks. The Agreement provides:

⁴ Merchant processing generally involves verifying credit card authorizations at the time of purchase, processing card transactions, settlement of card transactions, and depositing funds in merchants’ accounts.

The purposes of the Company are to engage in any activity and/or business for which limited liability companies may be formed under the [Delaware LLC] Act... provided, such activities and or businesses are permissible for national banking associations; and, provided further, all required notices and applications have been submitted to the OCC and, if and as required by Requirements of Law, the OCC has consented to such activity and/or business... .

Section 2.3, Agreement

In addition, any decision to undertake new activities will require the approval of a majority of the Management Committee.⁵ The Management Committee will be comprised of four Managers, with two Managers designated by FDMS and two by BBCC. Section 6.10(a)(vii) of the Agreement further provides that BBCC has the right to withdraw from the Company at any time after the first anniversary of the LLC's formation. As a result, the Bank, through BBCC, will be able on an on-going basis to prevent the LLC from engaging in new activities that may be impermissible for national banks. Therefore, this 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 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 a national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Delaware limited liability company will 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. Del. Code Ann. Tit. 6 § 18-303 (1994).⁶ Thus, the Bank's loss exposure for the liabilities of the LLC will be limited by statute and the Agreement establishing the LLC.

⁵ Under Delaware law, a LLC may engage in "any lawful business, purpose or activity with the exception of the business of granting policies of insurance, or assuming insurance risks or banking as defined in § 126 of Title 8." Del. Code Ann. tit. 18 § 126 (1994). Banking is defined in § 126 of Title 8 of the Delaware Code as the "power of issuing bills, notes or other evidence of debt for circulation of money, or the power of carrying on the business of receiving deposits of money." Del. Code Ann. Tit. 8 § 126 (1994). In the course of its business activities the LLC will not engage in any of the foregoing activities.

⁶ Article VI, section 6.1 of the Draft LLC Agreement specifically provides that "[n]o member shall be liable for the debts, obligations or liabilities of the Company, including under a judgment, decree or order of a court."

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 as an unconsolidated entity under the equity method of accounting. Under this method, 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. *See generally*, Accounting Principles Board, Op. 18 § 19 (1971) (equity method of accounting for investments in common stock). Interpretive Letter No. 692, *supra*. Similarly, under the cost method of accounting, the investor records an investment at cost, dividends or distributions from the entity are the basis for recognition of earnings, and losses recognized by the investor are limited to the extent of the investment. In sum, regardless of which accounting method is used, the investing bank's potential loss is limited to the amount of the investment.

As proposed, the Bank will have a 50 percent ownership interest in the LLC through BBCC. The Bank believes, and its accountants have advised, that the appropriate accounting treatment for the Bank's investment is the equity method.⁷ Thus the Bank's loss from an accounting perspective would be limited to the amount invested in the LLC and the Bank will not have any open-ended liability for the obligations of the LLC.

In addition, as noted above, Delaware law limits members' losses to their capital investment. The LLC Agreement contains provisions that confirm that no investor in the LLC will have liability for the debts, obligations, and liabilities of the LLC. Since the Bank will not have open-ended liability for the obligations of the LLC, 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. Twelve U.S.C. § 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has

⁷ OCC's Chief Accountant has concluded that the Bank's investment in the LLC should be recorded as "Investments in unconsolidated subsidiaries and associated companies" on the Bank's Consolidated Reports of Condition and Income ("Call Reports"). Such classification is consistent with the Call Report Instructions. *See* Instructions to Schedule RC-M, item 8.b.

been judicially construed to mean “convenient or useful”. *See Arnold Tours, Inc. v. Camp*, 472 F. 2d 427, 432 (1st Cir. 1972). The provision in 12 U.S.C.

§ 24(Seventh) relating to the purchase of stock, derived from section 16 did not authorize speculative investments in stock. *See* Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [Current] Fed. Banking L. Rep. (CCH) ¶ 81,012. Therefore, a consistent thread running through our precedents concerning stock ownership is that it must be convenient or useful to *that bank’s* banking business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See, e.g.*, Interpretive Letter No. 543, *reprinted in* [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,225 (February 13, 1991); Interpretive Letter No. 427, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); Interpretive Letter No. 421, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988).

The Bank, through BBCC, is currently actively involved in providing merchant processing services of the same or similar type as the LLC will provide. BBCC currently has a processing agreement with First Data Resources, Inc. (“FDRI”), an affiliate of FDMS. The Company (and pursuant to the processing services agreement, FDMS) will provide services to Bank customers which are currently provided by BBCC (and, pursuant to the processing services agreement, FDRI). Combining BBCC’s merchant processing services with those contributed by FDMS will be more cost effective, enhance efficiencies, and strengthen the Bank’s merchant processing business. Because FDMS is a leading provider of merchant processing services world-wide, its participation in this joint venture will help ensure the investment in technology needed to offer the Bank’s customers state-of-art merchant products and services.

Participation in the LLC will benefit the Bank in carrying out its banking business. In addition to enhancing the Bank’s existing merchant processing business, the opportunity to cross-sell other bank products and services to the merchants contributed to the Company by FDMS initially and the merchants subsequently solicited for new business by the FDMS sales force, will also be convenient and useful to the Bank in carrying out its other banking business. Thus the investment is “necessary” to the Bank’s ability to efficiently and capably carry out its banking business and to compete more effectively in the merchant processing services market.

For these reasons, the Bank’s investment in the LLC is convenient and useful to the Bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

C. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, we conclude that BankBoston, N.A. may acquire and hold through BBCC, a

50 percent interest in the LLC. Our conclusion is conditioned upon BankBoston's compliance through BBCC with the following conditions:

- (1) The LLC will engage only in activities that are part of or incidental to the business of banking;
- (2) The Bank, through BBCC, will have veto power over any activities and major decisions of the LLC that are inconsistent with condition number one, or will withdraw from the LLC in the event it engages in an activity that is inconsistent with condition number one;
- (3) The Bank will account for the investment in the LLC under the equity method of accounting;
- (4) BBCC and the LLC 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.

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

If you have any questions, please contact Richard Erb, Licensing Manager, at (202) 874-4610.

Sincerely,

/s/

Julie L. Williams
Chief Counsel