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Richard J. Weaver
Commissioner of Finance

November 16, 2012

Re: Interpretive Letter 2-2012: Request under Section 362.106(4), RSMo. Activity requested – state banks ability to make (1) investments in and loans to first-tier and second tier operating subsidiaries to the same extent that national banks may make investments in and loans to its first-tier and second-tier operating subsidiaries and (2) loans that qualify for federal and/or state new market tax credits ("NMTC Loans") through a second-tier operating subsidiary to the same extent that national banks may make such loans through an operating subsidiary.

In a letter dated September 18, 2012, on behalf of your client, you requested a determination from this office that would permit Missouri state-chartered banks to make (1) investments in and loans to first-tier and second tier operating subsidiaries to the same extent that national banks may make investments in and loans to its first-tier and second-tier operating subsidiaries and (2) loans that qualify for federal and/or state new market tax credits ("NMTC Loans") through a second-tier operating subsidiary to the same extent that national banks may make such loans through an operating subsidiary.

Under § 362.106(4)(e), RSMo, state-chartered banks may conduct any activity that national banks are expressly authorized to conduct, if the Missouri bank has provided notice to the Director of Finance who determines within the thirty (30) day notice period, if not extended by the Director, that the proposed activity is not unsafe or unsound and the bank meets the conditions prescribed for national banks. The director may either take no action or issue an interpretive letter that specifically describes the activity permitted and limitations on the activity.

FACTS

The request is predicated upon the following organizational structure. The Bank will form or acquire a limited liability company (LLC) as a first-tier subsidiary (First-Tier Operating Subsidiary) which will meet the definitions of an "operating subsidiary" of a national bank under the Office of the Comptroller of the Currency (OCC) regulations. In exchange for its equity investment, the Bank will acquire all of the voting member interests of the First Tier Operating Subsidiary, and will have the power to appoint and replace the manager of the LLC. Third-party investors (Third Party Investors) will purchase non-voting member interest of the First-Tier Operating Subsidiary. The Bank will provide approximately one percent and the Third-Party Investors will provide approximately 99 percent of the total equity capital of the First-Tier Operating Subsidiary. The Bank will also make a term loan (Leverage Loan) to the First-Tier Operating Subsidiary.

The First-Tier Operating Subsidiary will form or acquire a second LLC as a Second-Tier Operating Subsidiary (Second-Tier Operating Subsidiary), which will also meet the OCC regulatory definition of an "operating subsidiary" of a national bank. The First-Tier Operating Subsidiary will invest the proceeds of the Leverage Loan and the equity investments from the Bank and the Third-Party Investors in the Second-Tier Operating Subsidiary, in exchange for all the voting member interests of the LLC and the power to appoint the managing member of the LLC. The managing member will acquire a non-voting member interest in the Second-Tier Operating Subsidiary. The First-Tier Operating Subsidiary will provide 99.0 percent of the total equity capital of the Second-Tier Operating Subsidiary. The managing member will provide a nominal 1.0 percent of the total equity capital of the Second-Tier Subsidiary.

The Second-Tier Operating Subsidiary will make commercial loans, including NMTC Loans, that the Bank itself could make in reliance upon its general lending authority under state law. The NMTC Loans will be underwritten using the same safety and soundness considerations utilized by the Bank.

The Second-Tier Operating Subsidiary will operate so that it qualifies as a "community development entity" (CDE) under the Internal Revenue Code (IRC) §45D. The NMTC Loans made by the Second-tier Operating Subsidiary will meet the definition of "qualified low-income community investments" (QLICI) under IRC §45D. The borrowers of such loans will meet the definition of "qualified active low-income community borrowers" (QALICB) under IRC §45D. The Second-Tier Operating Subsidiary will not make any equity investment in a QALICB, CDE or NMTC project.

The Second-Tier Operating Subsidiary will receive allocations or sub allocations of federal and/or state new market tax credits (NMTC). The NMTC Loans made by the Second-Tier Operating subsidiary will be eligible for NMTCs. The NMTCs will pass through the Second-Tier Operating Subsidiary up to the First-Tier Operating Subsidiary and then will pass through to the members of the First-Tier Operating Subsidiary. Federal NMTCs will be passed through in proportion to the member's equity investment in the First-Tier Operating Subsidiary, while state NMTCs will pass through only to the Third-Party Investors.

National Bank Authority

Included in a national bank's powers to act are "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. §24 (Seventh). A national bank, after the applicable notice and application to the OCC, may exercise any power that it may engage in directly through an operating subsidiary. 12 CFR §5.34(e). National banks may invest in limited liability companies provided the requirements of 12 CFR § 5.34(e)(2) are met including but not limited to the requirement that a bank has the ability to control management and operations of the subsidiary. There are no specific investment limitations on a national bank's investment in an operating subsidiary.

National banks are authorized to lend money to its operating subsidiaries under its general powers to lend found in 12 U.S.C. §24 (Seventh). The general lending limit for national banks is found in 12 CFR §32.1. Loans to subsidiaries are specifically excluded from the general lending limit. 12 CFR §32.1(c)(1)(ii). Under 223.2(a), subsidiaries are excluded from the definition of affiliate for Regulation W purposes. Because loans to subsidiaries are not covered by either the general lending limit nor those imposed by Regulation W, there is no lending limit on loans made by a national bank to an operating subsidiary.

Pursuant to 12 U.S.C. 24 (Eleventh), national banks may make investments in projects "designed primarily to promote the public welfare, including the welfare of low and moderate income communities or families ..." within the limitations established in that provision. These investment limitations are separate from lending limitations that would also apply to public welfare projects. *See, eg*, OCC Interpretive Letter #1076 (December 2006).

When an operating subsidiary is engaged in lending activity, it is subject to the same lending limitations as if the bank had made the loan directly. 12 C.F.R § 5.34(e)(5)(v). This includes the limitation on loans to a single borrower found in 12 U.S.C. § 84 and 12 C.F.R. §32.3.

Missouri Authority

Under Missouri law, § 362.106(4)(e), upon approval of the Director of the Division of Finance, a Missouri bank may conduct any activity that a national bank is authorized to conduct if it meets prescribed standards applicable to such activity. In granting approval, the director must also determine that the proposed activity is not an unsafe or unsound practice and that the bank meets the prescribed standards for conducting such activity.

Missouri banks have their powers enumerated in §362.105. Those powers may be exercised "directly or through a subsidiary." § 362.105.1. Subsidiary is defined as "one or more business entities of which the bank or trust company is the owner, provided the owner's liability is limited by the investment in and loans to the subsidiary as otherwise provided for by law." §362.105.5. No application to or prior approval by the Division is necessary to form an operating subsidiary. Missouri statutes do not contain an investment limitation on investments in subsidiaries outside general safety and soundness concerns.

Subsidiaries of Missouri banks are also able to invest in lower tier subsidiaries pursuant to §361.105.1. Again, there are no quantitative limitations on those investments outside general safety and soundness concerns. These lower tier subsidiaries can engage in any business activity that the bank is authorized to engage in including making loans.

Missouri law allows banks to make loans to operating subsidiaries pursuant to their general lending authority. There is no specific lending limit with respect to operating subsidiaries. Therefore, loans to subsidiaries would be subject to the general lending limits found in §362.170.

Pursuant to § 362.105(15), banks may "make debt or equity investments in corporations or projects, whether for profit or not for profit, designed to promote the development of the community and its welfare" as long as the limitations prescribed in the Division's wild card letter are followed. *See*, Division of Finance Interpretive Letter 1-2009.

Summary and Findings

In granting approval pursuant to § 362.106(4)(e), the director must determine that the proposed activity is not an unsafe or unsound practice and that the bank meets the prescribed standards for conducting such activity.

There is no issue that under both federal and state law a bank may form a subsidiary to engage in the same business that the bank is allowed to engage in. Neither federal nor state law limits the amount of the equity investment that a bank may make in a subsidiary whether it be a first or second tier subsidiary.

Banks may also make loans to operating subsidiaries. Based on the findings in this letter, those loans are not subject to the limitations of §362.170 because there is no quantitative limitation on a national bank's ability to loan to an operating subsidiary.

Both federal and state law also allow banks to invest in or make loans to projects deemed to promote the development of the community and its welfare. Investment limitations are separate from lending limitations to the same project. Therefore, a bank or its operating subsidiary may make investments up to the limitation established in law as well as a extend credit within the legal limitations for making a loan to such a project. To the extent investments are made in such projects, the Division has previously issued a Wild Card Letter establishing limitations on such investments. *See*, Division of Finance Interpretive Letter 1-2009.

While the requested transaction can be done under this wild card letter, any bank wishing to engage in such a transaction must adhere to the following conditions:

1. The bank must have a composite CAMELS rating of "1" or "2" based on the most recent state or federal regulatory examination prior to engaging in such a transaction. Should the bank fail to maintain such CAMELS rating, it shall not create additional first or second tier operating subsidiaries designed for this purpose nor shall it make additional equity investments in existing operating subsidiaries designed for this purpose nor provide additional loans for such purpose.

2. The bank shall remain "well capitalized" as defined by 12 CFR § 6.4 based on the most recent Reports of Condition that are filed and reviewed quarterly. Should a bank fail to meet this criteria, the bank shall not create or make equity investments or additional loans to existing operating subsidiaries.

3. No de novo bank shall engage in the requested transactions.

4. The bank must control the first-tier operating subsidiary, and the first-tier operating subsidiary shall control the second-tier operating subsidiary, through the ownership of voting member interests in the LLCs.

5. The investments the bank makes, whether directly in the first-tier or indirectly through the second-tier, cannot expose the bank to unlimited liability.

6. The bank shall not indemnify the NMTC Investors with respect to their investment in the first-tier operating subsidiary or the tax credits related to such investments.

7. Both the first-tier operating subsidiary and the second-tier operating subsidiary of the bank shall meet all of the criteria of an "operating subsidiary" under the OCC regulations applicable to a national bank (as if the Missouri bank were a national bank), including the consolidation of the financial statements of the first tier operating subsidiary and the second-tier operating subsidiary with the financial statements of the bank under GAAP accounting.

8. The bank must provide notice to the Division thirty (30) days prior to engaging in the requested activity.

9. The first-tier operating subsidiary shall not make any equity investments other than its equity investment in the second-tier operating subsidiary.

10. The second-tier operating subsidiary shall not make any equity investment in any entity or NMTC project.

11. The activities of the second-tier operating subsidiary shall be limited to making and servicing NMTC loans and operating as a CDE under IRC §45D.

12. The NMTC Loans made by the second-tier operating subsidiary shall be made consistent with safe and sound banking practices, and in compliance with statutes and regulations that would be applicable to the bank if the bank itself made the loan, including but not limited to lending limits in §362.170.

Because NMTCs may be allocated in multiple years and by multiple states and Third-Party Investors will want tax credits from specific states or for specific years, a Missouri-bank may establish multiple pairs of first-tier and second-tier operating subsidiaries in reliance upon this interpretive letter.

Prior to engaging in the requested activity, the bank should institute policies specific to the activity which should include, at a minimum, the following:

1. Establish prudent limits for investment and loans in relation to capital, total loans and total assets.

2. Ensure bank maintains sufficient number of qualified management and staff to prudently underwrite risks and appropriately administer volume.

3. Ensure proposed activities are appropriately reviewed in the scope of internal and external audit activities, including loan reviews.

4. Ensure the Loan Policy is expanded to establish appropriate standards and procedures to prudently mitigate risks related to this field of lending. In addition to addressing any requirements specific to the NMTC program established by the US Treasury, the Loan Policy should:

   - Require each proposed loan or investment related to the NMTC program to be pre-approved by the Board or appropriate loan committee;

   - Require all loans to meet existing underwriting standards set forth in general loan policy;

   - Establish any additional standards unique to NMTC fields of lending;

   - Define types of desirable loans; and

   - Specify targeted trade area and establish limits on percent of capital for overall out of territory lending as well as specific geographic areas.

5. Establish appropriate parameters/limits and monitoring procedures to ensure prudent risk diversification for both loans retained and loans sold in secondary market.

6. Ensure Board reports are sufficient to allow for monthly monitoring of NMT lending and investment activities. At a minimum, the report should include:

   - Detail any new loans or investments including the amount, terms, location of business and/or collateral, financial capacity of obligor/guarantors, and any other details the Board considers appropriate.

   - Summarize overall volume of activity by number of transaction and dollar volume to date and compare against policy limits.

This letter will be filed today with the Office of the Missouri Secretary of State and posted on the public internet website of the Division of Finance. It will become effective ten (10) days after filing with the Secretary of State. If you have any questions regarding this matter, please contact Christie Kincannon, Chief Counsel for the Division.

Very truly yours,

Richard J. Weaver
Commissioner of Finance

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cc: Corporations Division
Secretary of State