Office of Thrift Supervision
Department of the Treasury
Chief Counsel
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6251

September 15, 1995

[redacted]

RE: Authority of Federal Savings Associations to Invest in Stock Corporations Operating Electronic Funds Transfer Systems

Dear [redacted]

This responds to your request for confirmation that the federal savings association members of [redacted] a nonstock corporation operating an electronic funds transfer ("EFT") system (the "EFT Corporation"), may acquire stock in a newly-formed stock corporation ("New EFT Corporation") as part of a restructuring.

For the reasons set forth below, we conclude that the federal savings association members of EFT Corporation have authority pursuant to the incidental powers doctrine to acquire stock of New EFT Corporation, subject to the conditions described herein.

I. Background

EFT Corporation is a [State A] nonstock corporation. The [redacted] members of EFT Corporation consist exclusively of insured depository institutions including national and state banks, state savings and loan associations, state savings banks, federal and state credit unions, and [redacted] federal savings associations ("Members").

EFT Corporation operates an EFT system that permits customers of its Members to use plastic cards containing magnetically encoded information to perform banking transactions through any Member-maintained automated teller machine ("ATM") that is part of the network. EFT Corporation also operates a point-of-sale ("POS") program under which cardholders may use their cards to purchase goods and services from retailers that have installed network POS devices in their stores.

For various business reasons, EFT Corporation is proposing to restructure to become a stock corporation. You indicate that the conversion of a nonstock corporation to a stock corporation cannot be accomplished under [State A] law. Therefore, EFT Corporation will form a nonstock [State B] corporation and merge into it. The [State B] nonstock corporation will then convert to a [State B] stock corporation that will qualify to do business in [State A] and will have its headquarters in [State A] The final corporation is referred to herein as "New EFT Corporation."

New EFT Corporation will have three types of stock -- voting common stock, nonvoting common stock and preferred stock. The membership interests of all EFT Corporation Members eligible to participate in the restructuring will be converted into shares of New EFT Corporation voting common stock based on a value allocation method that takes into account a Member's initial membership contribution, its number of transactions completed during a specified 12-month period, and that portion of fees paid by the Member and retained by EFT Corporation during such 12-month period for routing transactions to and from the Member's ATMs, cash dispensers and POS terminals. New EFT Corporation voting common stock also may be offered to insured depository institutions that join the EFT system after the restructuring.

Member institutions will be permitted to transfer their voting common stock only to other depository institutions that participate in the New EFT Corporation network. Moreover, any such transfer will be subject to a right of first refusal of the New EFT Corporation. New EFT Corporation will also have the option (but will not be required) to redeem the stock of a Member institution that ceases to participate in the EFT Corporation network.

Shares of New EFT Corporation's nonvoting common stock or preferred stock may be issued in the future to an investor to procure funding for research and development or new product development costs. In addition, in order to prevent the concentration of voting power in a single Member institution, New EFT Corporation's articles of incorporation will provide that if an institution and its affiliates acquire more than 25% of the total shares of voting common stock outstanding, the excess shares will automatically be converted into nonvoting common stock.

II. Discussion

The Office of Thrift Supervision ("OTS") and its predecessor have long taken the position that, under certain circumstances, federal savings associations have authority under the incidental powers doctrine to invest in corporations that engage exclusively in activities that federal savings associations may conduct directly, without

being required to comply with the statutory and regulatory service corporation and operating subsidiary requirements.[1] One of the types of investments authorized under this line of authority is investments in so-called "joint-user corporations." These investments are permissible when "the predominant purpose of the investment is 'to facilitate participation in an . . . activity for which the joint participation of several . . . users [is] required,' rather than to 'engage in speculative activity through stock investment.'"[2] Authorization to invest in joint-user corporations is based on a recognition that no purpose would be served by preventing federal savings associations from joining with others to engage in an activity that could be conducted directly, especially when joint participation reduces capital outlays and operating costs, enhances profitability, or serves other bona fide business objectives, without jeopardizing safety and soundness.

The OTS has developed five criteria for testing whether a proposed investment in a for-profit stock corporation represents a genuine non-speculative investment motivated by a desire to achieve economies of scale by pooling resources with other institutions:

1. Are the activities of the corporation limited to those that the investing association could engage in directly?

2. Are the services of the corporation of a type that are rendered more effective or efficient when several institutions join together?

3. Is ownership of the corporation limited to users of the services provided by the corporation?

4. Are there transfer and redemption restrictions that make it unlikely that the investing association could ever resell the stock of the corporation at a significant gain?

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[1] 12 U.S.C.A. § 1464(c)(4)(B) and 12 C.F.R. §§ 545.74 and 545.81 (1995). New EFT Corporation will not qualify as a service corporation because, inter alia, ownership in the Corporation will not be restricted to savings associations. New EFT Corporation will not constitute an operating subsidiary because, inter alia, no one savings association will control more than 50% of the voting stock of the Corporation.

[2] OTS Op. Chief Counsel (Nov. 23, 1992) at 3-4, quoting Office of the Comptroller of the Currency Interpretive Letter No. 554, May 7, 1990, reprinted in [1991-92 Transfer Binder] Fed. Banking L. Rep. (CCH) Par. 83,301, and citing FHLBB Op. by Quillian (April 2, 1986). See also, OTS Op. Chief Counsel (Dec. 13, 1993) at 4 (pursuant to the incidental powers doctrine, federal savings associations may jointly invest in the common-stock of a for-profit corporation that provides data-processing services without being subject to the service corporation investment restriction).

5. Would the association's proposed investment in the corporation, at the time the investment is made, be no greater than reasonably necessary to meet the legitimate capital needs of the corporation, and would the investment be roughly proportionate to that of other similarly situated participating institutions?[3]

Based upon your description, the proposed restructuring of EFT Corporation would clearly meet at least three of these five criteria. The services to be provided by New EFT Corporation are clearly of a type that would be rendered more efficient or effective when several institutions join together (Criterion 2); there appear to be sufficient restrictions on the transfer of New EFT Corporation common stock to make it unlikely that it could ever be sold at a significant gain (Criterion 4); and the formula for issuing stock in the reorganization appears to be designed to reflect each Member's relative use of the system (Criterion 5). However, the proposed restructuring raises questions under Criteria 1 and 3.

Pursuant to Criterion 1, the activities of New EFT Corporation must be limited to those that federal savings associations may conduct directly. The basic business proposed for New EFT Corporation (operating an EFT network) is an expressly authorized activity for federal savings associations.[4] However, New EFT Corporation's prospectus indicates that it may also engage in research and new product development ("R&D activity") of an unspecified volume and nature. In conversations with us, you stated that you anticipate that any R&D activity conducted by New EFT Corporation will be limited to upgrading the Corporation's current software and systems, and adapting and incorporating new products developed by others for use by the Corporation.

Although federal savings associations clearly have authority to engage in certain types of research and development (e.g., developing new financial products), the precise scope of the research and development authority of federal savings associations has never been defined. The limited R&D activities described above clearly fall within the scope of what is permissible for federal savings associations. However, if New EFT Corporation should ever wish to engage in broader R&D activities, you should consult with OTS in advance to ensure that the proposed activities would be permissible for federal savings associations.

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[3] OTS Op. Chief Counsel (Nov. 23, 1992) at 4. See also, OTS Op. Chief Counsel (Dec. 13, 1993) at 5.

[4] 12 C.F.R. § 545.141 (1995).

Pursuant to Criterion 3, ownership of New EFT Corporation must be limited to users of the services provided by the Corporation. You indicate that ownership of the voting common stock of New EFT Corporation will be reserved exclusively for users of the EFT system. You hold open the possibility, however, that nonvoting common stock or preferred stock may be issued at some future date to investors who do not use the Corporation's system. The primary purpose behind Criterion 3 is to ensure that control of a joint-user corporation remains with institutions using the system, so that persons with speculative profit motives do not gain control of the corporation. Thus, we would not object to issuance of nonvoting common and preferred stock to non-users of the EFT system provided these shareholders would have no voting rights absent default on the terms of their stock.

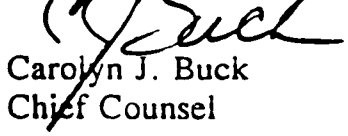
Finally, we also note that New EFT Corporation will be subject to the requirements imposed on the EFT operations of federal savings associations by 12 C.F.R. § 545.141 (1995), including requirements regarding privacy of account data and OTS examinations.

Provided the foregoing conditions are observed, we conclude that federal savings associations have legal authority to invest in the New EFT Corporation.

In reaching this conclusion, we have relied on the factual representations contained in the materials you submitted to us and made by you and others in your firm in conversations with OTS staff, as summarized herein. Any material change in facts from those set forth herein could result in a different conclusion. We also note that this opinion is issued in reliance upon your representation that New EFT Corporation will provide a copy of this letter to each federal savings association that invests in the Corporation, whether as a part of the restructuring or thereafter, prior to the association's commitment to invest.

If you have any questions regarding this response, please feel free to contact Susan Miles, Senior Attorney, at (202) 906-6798.

Very truly yours,



Carolyn J. Buck
Chief Counsel

cc: All Regional Directors
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