



Office of the Comptroller of the Currency

Interpretive Letter #754

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12 U.S.C. 24(7) & 12 C.F.R. 1

Mr. Winton A. Winter
President
Peoples National Bank & Trust
P.O. Box 20
Ottawa, Kansas 66067-0020

Re: Notification of Intent to Establish an Operating Subsidiary to Engage in Computer Networking Services for Other Financial Institutions Application Control Number: 96-MW-08-0031

Dear Mr. Winter:

This is in response to your June 5, 1996 notification on behalf of Peoples National Bank & Trust, Ottawa, Kansas (the "Bank"), concerning the establishment of InterBank 1, Inc. ("InterBank") as an operating subsidiary of the Bank. InterBank provides investment portfolio management services for the Bank and computer networking packages for other financial institutions. Based on the information and representations you provided and the reasons discussed below, the Bank's notification is hereby approved.

Background

InterBank would be a wholly-owned operating subsidiary located at the Bank's branch bank in Stilwell, Kansas. As stated above, the purpose of InterBank would be twofold. First, InterBank would hold and manage the Bank's investment portfolio. Specifically, InterBank would manage, invest, and reinvest cash, U.S. government obligations, and other marketable securities in accordance with the Bank's investment guidelines.

Second, InterBank would provide computer networking services to other financial institutions. Specifically, InterBank would assist its customers in the installation and maintenance of local area networks ("LANs") (**NOTE:** A "LAN" is a communications network that connects various hardware devices within a particular building or buildings in very close physical proximity. For example, a LAN enables employees at a bank to share information with other employees at that particular bank location or with other employees at locations within the same city block.) and wide area networks ("WANs") (**NOTE:** A "WAN" is a linkage of two or more LANs. These LANs do not need to be in close physical proximity. For example, a WAN enables employees at a particular bank to send electronic data and messages to employees at branches in other communities.) designed to facilitate the financial services business of those customers. In order to enable computer systems to communicate with one another, a networking provider, such as InterBank, must use both hardware (**NOTE:** Computer hardware is,

as the name suggests, the physical components that comprise a computer system. For example, the computer itself, monitor, hard drive, server, modem, printer, and connection wiring are all considered computer hardware.) and software. (NOTE: Computer software is the programs, which are the set of instructions written in computer language, that tell the computer what to do and how to do it.) InterBank would offer comprehensive networking packages consisting of: (1) hardware and software; (2) consulting services (including assessment of customers' needs, technical information and strategic planning, and installation and configuration of equipment); and (3) support services (including employee training and ongoing system maintenance).

The types of computer networks that InterBank would provide would enable users in different locations to share software, files, data, electronic messaging, and hardware, for example, to enable a main bank and its branch facilities to centralize loan processing. The branch uses its LAN and WAN to access the main bank's loan origination software and transfer the required data to the main bank. In turn, the main bank processes the loan applications for the branch, communicates the status of the applications, and prints the completed loan documents directly at the branch site.

The networks will also facilitate data processing by InterBank's financial institution customers. Historically, one of the methods by which the banking industry accomplished data processing, such as updating customer account information, was by physically transporting the data on tapes from the bank to a data processing provider. The data processing provider then compiled the data and sent the updated information back to the bank on tapes. As technology advanced, banks began using computer modems to transfer data back and forth, usually in batches during non-business hours. Through more recent advances in technology, banks are now able to use computer networks to instantaneously transfer data and receive current information on customer accounts.

You also indicate InterBank would offer hardware in connection with the networking packages it provides to its financial institution customers. This aspect of the business would be a convenience to InterBank's customers because they would avoid having to deal with multiple vendors. It also would enable InterBank to install and test the networking software at its own location, rather than at the customers' locations, and it would allow InterBank to control the quality and uniformity of the hardware that InterBank would support.

Further, InterBank's networking services would not be contingent upon the customers' purchase of hardware from InterBank, and there would be no tying arrangements or price discrimination. InterBank would sell hardware only in connection with its networking packages. InterBank would not maintain a retail inventory of computer hardware or software, and all items that would be purchased for customers would be used to fill specific orders. Finally, InterBank's gross profits from the sale of hardware (the retail price less the cost InterBank extends for the goods sold) would account for less than thirty percent of its gross profits from the sale of the computer networking packages; the bulk of InterBank's gross profits would be derived from its sale of software and consulting and support services.

Discussion

A. Statutory Framework

The National Bank Act provides that national banks shall have the power:

To 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

Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.

12 U.S.C. § 24(Seventh).

The Supreme Court has held that this clause is a broad grant of authority to engage in the business of banking including, but not limited to, the five express powers and the business of banking as a whole. *NationsBank of North Carolina, N.A. v. Variable Life Annuity Co.*, 115 S. Ct. 810, 814-15 & n.2 (1995) ("VALIC"). Judicial precedent reflects three general principles for determining whether an activity is within the scope of the "business of banking": (1) whether the activity is functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) whether the activity responds to customer needs or otherwise benefits the bank or its customers; and (3) whether the activity involves risks similar in nature to those already assumed by banks. *See, e.g., American Ins. Ass'n v. Clarke*, 856 F.2d 278, 282 (2d Cir. 1988); *M & M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978); *Merchants' Bank v. State Bank*, 77 U.S. 604 (1871). Furthermore, the Supreme Court has recognized that national banks have the authority to engage in activities that are incidental to the performance of the five express powers contained in 12 U.S.C. § 24(Seventh) or incidental to the performance of an activity that is part of the business of banking. VALIC, 115 S. Ct. at 814-15 & n.2. Finally, national banks may engage in activities that are part of, or incidental to, the business of banking by means of an operating subsidiary. 12 C.F.R. § 5.34(c) (1996).

B. Investment Portfolio Management Is Part of the Business of Banking

As set forth above, the National Bank Act expressly provides that national banks may purchase investment securities for their own accounts in accordance with the OCC's limitations and restrictions. 12 U.S.C. § 24(Seventh). The OCC's "Investment Securities Regulation," 12 C.F.R. § 1 (1996), prescribes limitations and restrictions on national banks' purchase of investment securities.

Because a national bank clearly has the authority to hold and manage its investment securities portfolio, a national bank's operating subsidiary may also engage in these activities on behalf of the bank. Therefore, InterBank's holding and managing of the Bank's investment securities portfolio in accordance with the Bank's investment guidelines would be within the power of a national bank pursuant to 12 U.S.C. § 24(Seventh) and 12 C.F.R. § 1.

C. The Sale of Computer Networking Software and Consulting and Support Services to Financial Institutions Is Also Part of the Business of Banking

Providing financial institutions with computer networking software and consulting and support services that are designed to meet their specific banking needs satisfies each of the three general "business of banking" principles.

1. The activities are functionally equivalent to or a logical outgrowth of a recognized banking activity

National banks have traditionally performed for other financial institutions an array of activities called "correspondent services." In *United States v. Citizens and Southern Nat'l Bank*, 422 U.S. 86, 114-15 (1975), the Supreme Court quoted with approval the following:

"Dating back to colonial times, correspondent banking originally provided and extended network of independent unit banks with a link to financial centers, and at the same time furnished substitute central banking functions. Today, as a vital component of the era of electronic banking, it enables

city correspondents to provide customers with a range of services that is varied, extensive and constantly expanding, one survey lists as many as fifty different categories." (NOTE: Quoted from Austin & Solomon, A New Antitrust Problem: Vertical Integration in Correspondent Banking, 122 U. Pa. L. Rev. 366, 367-368 (1973).)

The Court then observed:

Among the services typically provided within a conventional correspondent arrangement are check clearing, help with bill collections, participation in large loans, legal advice, help in building securities portfolios, counseling as to personnel policies, staff training, help in site selection, auditing, and the provision of electronic data processing.

Id.

The OCC has long permitted national banks to offer correspondent services as part of the business of banking. See OCC Interpretive Letter No. 513, [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990) (permitting national banks to provide other financial institutions with loan application and disclosure documents, mail room processing, bank communication support services, and courier services); OCC Interpretive Letter No. 493, [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,078 (Nov. 22, 1989) (permitting national banks to perform traditional back office operations and customer services for other financial institutions); OCC Interpretive Letter No. 467, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,691 (Jan. 24, 1989) (permitting national banks to offer real estate appraisal services to other financial institutions); OCC Interpretive Letter No. 137, [1981-1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,218 (Dec. 27, 1979) (permitting national banks to pass on the benefits of their experience in managing a bank, improving the efficiency of internal operations, and marketing bank services).

More specifically, the OCC has allowed national banks as a permissible correspondent activity to provide data processing and other computer-related services to other financial institutions. For example, national banks may provide strategic planning and corporate development services, including assistance with program installation, simulation, and computer modeling. *Id.* National banks may also provide other financial institutions with electronic "gateways" to communicate and receive financial information and to conduct transactions. OCC Interpretive Letter No. 516, [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,220 (July 12, 1990) (bank operating subsidiary may participate in creating, leasing, and licensing communications systems, computers, analytic software, and related equipment and services for sharing information concerning financial instruments and economic information and news); OCC Interpretive Letter No. 346, [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,516 (July 31, 1985) (bank operating subsidiary may provide electronic information and transaction services and linkage for financial settlement services). Moreover, national banks may market specially designed computerized "smart phones" that enable other financial institutions to communicate with their customers through a supporting network of computers and software. OCC Interpretive Letter No. 611, [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,449 (Nov. 23, 1992). Finally, the OCC has previously concluded that national banks may provide communication support services to other financial institutions, including the use of electronic networks for transmission of visual, voice, and data communications. OCC Interpretive Letter No. 513, *supra*.

The Bank's proposal to provide computer networking packages directly to financial institutions is functionally equivalent to providing them with the electronic gateways and other communication devices

described above. As noted above, LANs and WANs are essentially communication networks that connect computers. They are merely another technological vehicle by which electronic data is transferred, an activity the OCC has held to be a permissible correspondent activity. In addition, financial institutions can use networking capabilities to facilitate data processing, which is also a recognized correspondent activity. Hence, the provision of networking packages that meet the banking needs of financial institution customers is a logical outgrowth of recognized correspondent banking services.

2. The activities respond to customer needs or otherwise benefit the bank or its customers

By providing computer networking packages, InterBank would respond to financial institutions' need to operate effectively in the increasingly computer-driven financial world. As described above, computer networks enable financial institutions to transfer customer information and utilize banking-specific software. For instance, computer networks enable financial institutions to use data processing software and receive precise, current information on customer accounts. Moreover, InterBank's sale of computer networking packages would benefit the Bank by allowing the Bank to utilize and be compensated for its expertise in this area. (NOTE: The OCC has recognized that in order to optimize the use of a national bank's resources, banks may market and sell to third parties electronic capacities that the bank has acquired or developed in good faith for banking purposes. 61 Fed. Reg. 4849, 4865 (1996) (to be codified at 12 C.F.R. § 7.1019); *see also* OCC Interpretive Letter No. 677, [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995) (national bank that acquired software development personnel, equipment, and facilities for legitimate banking and financial-related software may use some excess capacity to develop non-banking products).)

3. The activities involve risks similar in nature to those already assumed by banks

As discussed above, the OCC has long permitted national banks to provide banking-related computer technology to other financial institutions and to act as a gateway for the transmission of electronic information. The primary dangers inherent in these activities are the alteration, destruction, or delay in the transmission of the electronic information. The risks involved in acting as the intermediary in an electronic gateway arrangement are similar to the risks involved in providing computer networking packages directly to other financial institutions as proposed. Thus, providing computer networking packages to other financial institutions presents risks similar to those already assumed by banks.

Moreover, computer networking would not be a new venture for the Bank. The Bank established a network at its main bank in March 1993 and has subsequently established networks at its branch sites that allow them to communicate with each other and the main office. Therefore, the Bank has familiarity with establishing and maintaining a computer network. The Bank's experience in establishing and operating its own network is directly applicable to establishing networks for others.

D. The Sale of Computer Hardware to Financial Institutions Is Incidental to the Business of Banking

Finally, InterBank proposes to sell full function computer hardware to other financial institutions in connection with its sale of computer network services. This is a permissible incidental activity if done in accord with the Bank's representations.

OCC precedent has established that the provision of ancillary non-banking services is permissible as incidental to the business of banking when needed to successfully package and promote other permissible banking services. *See* OCC Interpretive Letter No. 742 (Aug. 19, 1996) (to be published) (bank may provide full Internet access to customers and non-customers in order to create a package of related services needed to satisfy consumer demand and enable the bank to successfully market its home banking services); OCC Interpretive Letter No. 653, [1994-1995 Transfer Binder] Fed. Banking L. Rep.

(CCH) ¶ 83,601 (Dec. 22, 1994) (national banks may offer non-banking products as part of larger product or service when necessary, convenient, and useful to bank permissible activities); OCC Interpretive Letter No. 611, *supra* (bank selling home banking service may also provide customer access to non-banking services "to increase the customer base and the usage of the program"); *cf. National Courier Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 516 F.2d 1229, 1239 (D.C. Cir. 1975) (banks may provide non-financial services, such as transportation of data processing materials, if necessary to facilitate permissible banking activities, such as data processing services).

As discussed above, InterBank's sale of computer networking software and consulting and support services to other financial institutions is a permissible banking activity. Thus, InterBank may sell general purpose computer hardware to other financial institutions if it is incidental to this permissible banking activity, i.e., convenient, or useful to providing the permitted services and subordinate within the packages as a whole.

The Bank indicates that the marketing of networking software and consulting and support services would be more efficient and successful when offered in conjunction with the necessary hardware. By offering the hardware as part of the networking packages, InterBank would meet the demands of its customers for a complete and ready-to-operate networking system of compatible software and hardware. Further, providing a package with hardware would ensure both the quality and uniformity of the networking equipment that InterBank contracts to support on an ongoing basis.

Conclusion

On the basis of the representations specified in your notification letter and other submitted materials, the OCC finds that the Bank may operate InterBank as a subsidiary and that the notification should be and is approved. If you have any questions, please contact Leslie G. Linville, Midwestern District Counsel, or Madelynn R. Orr, Attorney, at (816) 556-1870.

Sincerely,

/s/

Julie L. Williams
Chief Counsel