



Office of the Comptroller of the Currency

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12 U.S.C. 1831a(d)

12 U.S.C. 24(7)

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Re: Apollo Trust Company, Apollo, Pennsylvania

Dear Ms. Detwiler:

This responds to your request of June 25, 1996, that the Office of the Comptroller of the Currency (the "OCC") confirm that a national bank subsidiary may provide home banking services via a direct and Internet connection to the bank's home banking system and, incidental to that service, may also provide Internet access to customers and non-bank customers in the bank's service area. Apollo Trust Company, Apollo, Pennsylvania (the "Bank"), a state chartered bank, seeks the OCC's opinion in connection with its request for Federal Deposit Insurance Corporation (the "FDIC") approval under 12 U.S.C. 1831a(d) to establish a wholly owned subsidiary.<NOTE: Section 303 of the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. 1831a(d), provides that a subsidiary of an insured state-chartered bank, such as the Bank, may not engage as principal in any type of activity that is not permissible for a subsidiary of a national bank unless, the FDIC determines that the activity poses no risk to the Insurance Fund and the bank meets applicable capital standards.> The Pennsylvania Department of Banking previously approved the Bank's application to establish the proposed Internet banking subsidiary, finding the provision of such electronic banking services permissible under Pennsylvania Law. See Pa. Stat. Ann. tit. 7, 201(a)(vi). Based on the information and representations provided, and for the reasons discussed below, I conclude that the proposed activity is permissible for a national bank subsidiary.

BACKGROUND

The Bank is a community bank located in rural Apollo, Pennsylvania, approximately 35 miles northeast of Pittsburgh, Pennsylvania. The Bank currently operates a proprietary Bulletin Board System ("BBS"); maintains a Home Page on the Internet <NOTE: The "Internet" is an electronic communications medium based on a global system of interconnected computer networks of over 6.5 million computers world-wide. This system of computer networks transmits data over telephone lines, television cable and satellite links. Over 40 million people access the Internet using their home PCS to reach mainframes worldwide. In the U.S. alone, there are over 12 million households which subscribe to commercial online services such as America OnLine, CompuServe, and Prodigy that provide access to the Internet. Commerce over the Internet, including banking, represents a relatively small but growing percentage of all Internet traffic. An "Internet access service", such as that proposed by the Bank, provides an electronic gateway by which

service subscribers may connect their personal computers to the Internet using a modem and telephone line.> and provides banking services to its customers via the Bank's Home Page. These banking services include transferring funds between accounts, applying for loans and viewing account balances.

Using the Bank's BBS, customers and non-customers in the Bank's local service area may access the Internet with a local call. The Bank presently offers Internet access to its customers and to non-customers in its service area. Many community groups use the Bank's Internet service including local libraries, schools, local county governments and other public organizations. The Bank provides the least costly means of Internet access in the Bank's market area, as other service providers involve potentially costly toll calls.

To establish its Internet banking platform, the Bank acquired several server computers solely dedicated to the Bank's home banking and Internet services and has established a dedicated phone line connecting the Bank with its Internet access provider. The Bank represents that it will not incur any additional costs to use this equipment to provide Internet access to non-customers.

All users who contract to receive Internet access from the Bank's Internet banking subsidiary are required to sign a user agreement before accessing the Bank's Home Page. The user agreement outlines the rights and obligations of persons who choose to access the Internet via the Bank's BBS and limits the Bank's liability to the amount paid for such access.

The Bank represents that its home banking operation contains state-of-the-art security safeguards. The Bank's home banking operation is physically separate from the Bank's internal information systems. Customer transaction information is transmitted daily in batch form between the home banking servers and the Bank's internal information systems. The Bank represents that such a system minimizes the risk of unauthorized access to customers' financial information housed in the Bank's internal information systems.

Currently, 840 individuals subscribe to the Bank's Internet services. Approximately 525 are bank customers who also subscribe to the Bank's home banking services and 315 local residents who subscribe solely for Internet access. To access the Bank's services, a local area subscriber dials into the Bank's dedicated Bulletin Board server. Once subscribers have accessed the Bank's Bulletin Board server, they may choose to transact their banking business directly or to access the Internet for banking and non-banking purposes. The Bank's logo appears on the subscriber's computer screen from the moment the customer accesses the Bank's BBS until they connect to the Internet. Customers located outside the Bank's local area and those already in an Internet session may connect to the Bank's home banking services via its Home Page on the Internet. <NOTE: The Bank, by providing access to the Internet, does not provide an information service per se, but rather it acts as a communications gateway service enabling users to connect electronically with the Internet. The Bank's role is strictly that of an electronic interface between the customer and the Internet. It does not exercise any control over information content or web sites users access on the Internet. >

DISCUSSION

Statutory Framework

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

[t]o 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

12 U.S.C. 24(Seventh).

The Supreme Court has held that this clause is a broad grant of the power to engage in the business of banking including, but not limited to, the five specifically recited powers and the business of banking as a whole. See NationsBank of North Carolina, N.A. v. Variable Life Annuity Co., 115 S. Ct. 810 (1995) ("VALIC"). Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial precedent reflects three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. See, e.g., Merchants' Bank v. State Bank, 77 U.S. 604 (1871); M & M Leasing Corp. v. Seattle First National Bank, 563 F.2d 1377, 1382 (9th Cir. 1977), cert. denied, 436 U.S. 956 (1978); American Insurance Association v. Clarke, 865 F.2d 278, 282 (2d Cir. 1988).

Further, as the Supreme Court established in the VALIC decision, national banks are also authorized to engage in an activity if that activity is incidental to the performance of the five specified powers in 12 U.S.C. 24(Seventh) or incidental to the performance of an activity that is part of the business of banking. Before VALIC, the standard often considered in determining whether an activity was incidental to banking was that advanced by the First Circuit Court of Appeals in Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972) ("Arnold Tours"). The Arnold Tours standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its *express* powers under the National Bank Act." Arnold Tours at 432 (emphasis added). Even before VALIC, the Arnold Tours formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. OCC Interpretive Letter No. 494 reprinted in [1989-1990 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,083 (Dec. 20, 1989). The VALIC decision, however, established that the Arnold Tours incidental power formula includes those activities that are convenient and useful to the "business of banking," as well as activities incidental to the express powers specifically enumerated in 12 U.S.C. 24(Seventh). See Norwest Bank Minn., N.A. v. Sween Corp., 916 F. Supp. 1494 (D. Minn. 1996)

Internet Banking is Part of the Business of Banking

Providing facilities to enable customers to conduct banking activities via the Internet clearly satisfies each of the three general principles that we look to in evaluating whether an activity is part of the business of banking.

First, the Bank's proposal to provide banking services to its customers either by a direct telephone connection or by the Internet is simply the use of new electronic technology to provide recognized banking services. It is well established that a national bank may use electronic means to perform services expressly or incidentally authorized to national banks. See OCC Interpretive Letter No. 677, reprinted in [1994-1995 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,625 (June 28, 1995); OCC Interpretive Letter No. 284, reprinted in [1983-1984 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,448 (Mar. 26, 1984), OCC Interpretive Letter No. 449, reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,673 (Aug. 23, 1988). The OCC Interpretive Ruling setting forth this authority was recently revised, in recognition of the rapid advancement of technology, to authorize a national bank to "perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that

it is otherwise authorized to perform, provide or deliver." 61 Fed. Reg. 4849 (1996) codified at 12 C.F.R. 7.1019. Thus, national banks may provide personal computer home banking services to their customers, enabling such customers to obtain account information, transfer balances, and conduct other banking transactions, using telephone lines as the access device. See OCC Interpretive Letter No. 677, supra (national bank may acquire software development personnel, equipment and facilities to develop home banking software), and OCC Interpretive Letter No. 611, reprinted in [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,449 (Nov. 23, 1992) (national bank may provide banking services using specially designed computerized "smart phone").

Second, customers, who once could only access a bank's home banking servers through dedicated phone lines, will now have the option of connecting to the bank via the Internet. Providing bank services in the manner proposed by the Bank responds to customer needs. Bank customers will no longer be constrained to conduct their banking business during business hours but may do so whenever they choose through their personal computers. The Bank's system also gives customers dual means to access the Bank's home banking server to conduct their home banking activities. Customers can access the Bank directly when they are in the local calling area. When they are outside the Bank's local calling area, customers may connect to the Bank via the Internet. Local area customers who have connected to the Internet may also conduct their banking business during an Internet session without having to end the Internet session to connect directly to the Bank.

The Bank's proposal potentially benefits the Bank, as well as its customers. By providing home banking services to its customers, the Bank can increase the flexibility and responsiveness of its home banking services. The use of less costly electronic distribution channels also enables the bank to better compete with larger institutions.

Third, the risks a national bank confronts in providing home banking services in the manner proposed by the Bank are similar to the risks associated with the permissible activities of providing banking services via electronic means generally. To connect to the Bank's home banking servers, customers must enter their password to gain access to their account information. This information is then encrypted and transmitted to the Bank. This process serves both as an authentication mechanism and to protect the customers' confidential financial information from being intercepted and compromised when it travels across the telephone line used. Conducting the business of banking over an open system such as the Internet raises special security issues requiring systems and controls to manage these risks.

Internet Access for Bank Customers is Incidental to the Business of Banking

Providing its customers full Internet access, in the manner proposed by the Bank even though customers may use that access for non-banking purposes, is incidental to the power of a national bank as part of the "business of banking" to provide Internet home banking services to its customers under 12 U.S.C. 24(Seventh).

In a variety of contexts, the OCC has concluded that a national bank under its incidental authority may provide electronic gateway and communications services, enabling its customers to conduct the business of banking. See OCC Interpretive Letter No. 346, reprinted in [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,516 (July 31, 1985) (national banks may provide gateway service when service is electronic delivery means of banks' services); OCC Interpretive Letter No 419, reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,643 (Feb. 16, 1988) (national bank providing customers with a permissible electronic transactional information service may provide software to enable

customers to participate in service); OCC Interpretive Letter No. 513, reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,215 (June 13, 1990) (national banks permitted to establish an electronic network for transmission of visual, voice and data communications). National banks may, incidental to the business of banking, own the means of distribution and communication to provide services to their customers. Oklahoma v. Bank of Oklahoma, 409 F. Supp. 71, 90 (N.D. Okla. 1975). National banks may therefore own Internet servers, the technology that enables the actual connection to the Internet, so that they may deliver banking services to their customers over the Internet. While the Bank proposes to provide full Internet access which will enable customers to use the Internet for non-banking as well as banking purposes, full Internet access service also is permissible in this case for three reasons.

First, the full Internet access service is permissible under national banks' incidental authority to provide electronic products or services that can be used for both banking and non-banking functions as part of a package of banking related products or services where the full function products or services are not an excessive amount of the total package. OCC Interpretive Letter No. 611, supra, (sale of computerized telephone "smart phone" is incidental to banking even though the phone can be used for non-banking functions). See also OCC Interpretive Letter No. 345, reprinted in [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) 85,515 (July 9, 1985) (permitting a national bank to provide full function computer hardware as part of package of banking and financial data processing services); Letter from Michael J. O'Keefe, District Counsel, Midwestern District dated July 13, 1987 (unpublished) (distribution of software and hardware to banks permissible so long as full function hardware does not "dominate" permissible data processing services involved); OCC Interpretive Letter No. 516, reprinted in [1990-1991 Transfer Binder] Fed. Banking L. Rep. (CCH) 83,220 (July 12, 1990) (hardware permissible when necessary and convenient to information services and where sale of such incidental hardware does not exceed 30% of total cost of package); cf., Association of Data Processing v. Board of Governors, 745 F. 2d 677 (D.C. Cir. 1984).

In this case, the full access service adds virtually nothing to the cost of providing Internet home banking and does not dominate the Bank's home banking package. Even assuming that the Bank could separate its home banking functions from Internet access, it is impracticable to do so. Once the customer has entered his/her password and gained access to the Bank's BBS, the customer has accessed the Internet. From this connection, the customer is then automatically sent to the Bank's Home Page. The screen that the customers view is identical no matter whether they access it through the Bank's dedicated phone line or from the Internet.

Second, providing full Internet access creates a package of related services needed to satisfy consumer demand and enable the Bank to successfully market its home banking services. OCC precedent has established that the provision of such ancillary non-banking services is permissible as incidental to the business of banking when needed to successfully package and promote other permissible banking services. OCC Interpretive Letter No. 611, supra, (bank selling home banking service can also provide customer access to non-banking services "to increase the customer base and the usage of the program"); OCC Interpretive Letter No. 653, reprinted in [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). Cf., National Courier Ass'n v. Board of Governors, 516 F. 2d 1229, 1240 (D.C. Cir. 1975) (incidental powers of holding companies to provide specialized courier services when service necessary to obtain full benefit of data processing services).

Here, the full Internet access service is needed to successfully provide and market the Bank's Internet banking service. Limiting the Bank's gateway services, to block non-banking use, would create a hobbled home banking product unlikely to meet consumer demand. Customers in the midst of an Internet session wanting to view their account information would need to end the Internet session, then connect directly to the Bank. Such a cumbersome structure would not fully meet customer needs, causing them to search for more useful banking products offered by other institutions.

Third, in the Bank's situation, a national bank would be permitted to provide customers with full Internet access as a permissible use of its excess capacity acquired in good faith. A national bank, under its incidental authority, may market and sell excess electronic capacities acquired or developed by the bank in good faith for banking purposes. 12 C.F.R. 7.1019. See also OCC Interpretive Letter No. 677 (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). The acquisition of equipment and its attendant excess capacity will be in good faith if it is done in order to meet the needs of the bank and its customers for data processing activities that are part of the business of banking. This can occur where, as here, due to characteristics of the data processing equipment available on the market, the capacity of the most practicable optimal equipment available to meet the bank's needs may also exceed its precise needs. See e.g., Letter from Peter Liebesman, Asst. Director, Legal Activities and Services Division, dated Dec. 13, 1983 (unpublished).

A bank that has in good faith acquired excess Internet access capacity need not allow the excess capacity to go unused. The realities of Internet access and gateway systems technology demonstrate that the Bank would not incur additional costs to provide Internet access to its customers and non-bank customers located in the Bank's service area. The technological specifications of the equipment used to establish the Bank's Internet banking platform would legitimately have capacity in excess of that required to provide banking services over the Internet. Providing Internet access to its customers enables the Bank to benefit from the excess capacity resulting from the establishment of the Bank's Internet banking platform. See Letter from Stephen B. Brown, Attorney dated Dec. 20, 1989 (unpublished) (national banks may sell excess capacity in long-line telecommunications equipment where capacity acquired for anticipated future needs in private telecommunications network created to link branches and affiliated banks).

Providing Internet access does not present a unique risk to a bank. Guarding against unauthorized access to bank records and processes is a risk banks have faced historically in their roles as safekeepers of customers' assets and sensitive information. Today's banks, in addition to facing assaults on physical assets, also must protect their data processing systems from unauthorized access to information systems--the modern repositories of a customer's wealth-- through the erection of electronic "firewalls" or other mechanisms.

The Bank represents that it has taken many steps to address this risk. Its Internet activities are performed on servers solely dedicated to these functions. No electronic connection is maintained between these systems and the Bank's internal information systems. Therefore, even if an individual was to obtain unauthorized access to the Bank's Internet servers, the Bank's information systems would not be compromised. Moreover, the Bank represents that it has provided banking services over the Internet since January 1995 and, therefore, has some familiarity with the risks presented by conducting electronic banking services.

Internet Access for Non-Customers in the Manner Proposed is also Incidental to the Business of Banking

Finally, I conclude that providing Internet access to non-bank customers, in the manner proposed by the Bank, is incidental to the power of a national bank to provide Internet home banking services to its customers under 12 U.S.C. 24(Seventh).

National banks, like any other business, may engage in activities to establish their reputation as a good corporate citizen in the community, and to promote and advertise their goods and services. See, e.g., Franklin Nat'l Bank of Franklin Square v. New York, 347 U.S. 373 (1954) (national bank has power to advertise bank services); OCC Interpretive Letter No. 690, reprinted in [Current Transfer Binder] Fed. Banking L. Rep. (CCH) 81-005 (Oct. 2, 1995) (national bank may provide promotional merchandise bearing its logo so long as it engages in the activity primarily to market its banking services, not to make a significant profit on the merchandise itself). To that end, national banks may, to a limited extent, offer non-banking services to attract the public to its premises "in the hope of expanding their goodwill and thereby their banking business." Corbett v. Devon Bank, 299 N.E. 2d 521, 12 Ill App. 3d 559 (1973) (finding a national bank may sell motor vehicle licenses in its branch offices to attract customers).

Here, the Bank will offer Internet access to establish goodwill, and to promote and advertise its goods and services in its service area. Non-customer users of the Bank's Internet access include local libraries, schools and local governmental units. Providing Internet access to non-customers also specifically and effectively advertises the Bank's Internet banking services and increases the number of Internet banking customers. The Bank's Internet access service creates a class of active Internet users in the Bank's service area who are more likely to become customers of the Bank's home banking services.

Also, providing Internet access to non-bank customers in the Bank's service area is a valid and incidental distribution of excess capacity. As discussed earlier, a national bank may under its incidental authority distribute for non-banking purposes and uses its good faith excess capacity. 12 C.F.R. 7.1019. See also OCC Interpretive Letter No. 677 and OCC Interpretive Letter No 611, discussed above. It is well established that national banks are authorized to provide non-banking products developed through the utilization of such excess capacity to persons that have no banking relations with the institution. OCC Interpretive Letter No. 677, supra. Accordingly, the Bank may distribute its excess Internet capacity to non-customers.

CONCLUSION

Based upon the foregoing facts and analysis, and the representations made by the Bank in connection with its request, I conclude that the proposed activity is permissible for a national bank.

Sincerely,

/s/

Julie L. Williams
Chief Counsel