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MEMORANDUM

May 22, 2002

To Our Clients and Friends

Re: OCC's Final Rule on Electronic Activities of National Banks

The Office of the Comptroller of the Treasury ("OCC") has issued a final rule that brings together new and revised regulations concerning national banks' abilities to conduct business using electronic technologies. These regulations address:

- exercise of national banks' powers through electronic means
- location of a national bank that engages in electronic activities
- safety and soundness requirements for shared electronic space

The regulation regarding shared electronic space is effective July 1. All other portions of the rule are effective June 17th.

NATIONAL BANK POWERS

- **National Bank Finder Authority.** The rule codifies the OCC's position that it is part of the business of banking for a national bank to act as a finder, and also permits national banks to act as intermediaries in bringing together interested parties (not just buyers and sellers) to a transaction which can include non-financial products or services. However, the rule does not permit the bank to negotiate the transaction. The rule gives numerous examples of permissible finder activities. It also states that the authority to act as a finder does not enable a national bank to engage in brokerage activities that have not been found to be permissible for national banks.
- **Electronic Banking Activities That Are Part of, or Incidental to, the Business of Banking.** The rule defines the criteria the OCC will consider in determining whether an electronic activity is part of, or incidental to, the business of banking. The OCC will use the following four factors to determine if an electronic activity is part of the business of banking:

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- is the electronic activity a functional equivalent to or logical outgrowth of a recognized banking activity;
- does the proposed activity strengthen the bank by benefiting its customers or its business;
- does the activity present risks similar in nature to those already assumed by banks; and
- is the activity authorized for state-chartered banks.

In determining whether an electronic activity is “incidental” (i.e., convenient or useful) to the business of banking, the OCC will use the following criteria:

- does the activity facilitate the production or delivery of a bank’s products or services, enhance the bank’s ability to sell or market its products or services or improve the efficiency and effectiveness of the bank’s operations;
- does the activity enable the bank to use capacity acquired for its banking operations or otherwise avoid economic waste or loss.

In both instances, the weight given each factor by the OCC will be dependent upon the facts and circumstances of each case.

○ **Furnishing of Products or Services by Electronic Means and Facilities.**

The rule recodifies the “transparency doctrine” that states that a national bank may perform, provide, or deliver through electronic means and facilities any function, product or service that it is otherwise authorized to perform, provide or deliver. The rule provides examples of permissible activities under this authority. The rule clarifies that national bank activities will continue to be governed by OCC regulatory requirements and supervisory guidance, including considerations of safety and soundness, regardless of whether the activity is conducted electronically or by traditional means.

Many of the examples presented describe electronic finder activities, such as hosting, acting as a “virtual” mall and operating a telephone call center to provide finder services.

The rule further provides that applicability of state law to a national bank’s conduct of its authorized activities through electronic means and facilities is governed by traditional principles of Federal preemption and thus a state law would not be applicable to such activities if the state law stands as an obstacle to the achievement of a Federal objective, i.e., the ability of national banks to exercise uniformly their federally authorized powers.

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- **Composite Authority to Engage in Electronic Banking Activities.** A national bank may offer an electronic product or service comprised of several elements or activities if each of the individual elements or activities is authorized.
- **Sale of Excess Electronic Capacity and By-Products.** The rule affirms the OCC's long-standing doctrine that national banks may sell their "excess capacity" in order to avoid waste, and clarifies that the OCC's emphasis will be on a bank's objective reasons (as opposed to subjective intent or mental state) for obtaining the excess capacity. Under the rule, a national bank may market and sell excess electronic capacities "legitimately acquired or developed" by the bank for its banking business. The rule also recodifies the "by-product doctrine" that permits a national bank to sell by-products, such as software, legitimately acquired or developed by the bank for its banking business.
- **National Bank Acting as a Digital Certification Authority.** The rule codifies the OCC's past practice of permitting a national bank to act as a certificate authority and to issue digital certificates verifying the identity of the certificate holder. It also expands this authority by permitting national banks to verify through digital certificates any attribute for which verification is part of or incidental to the business of banking ("financial capacity certificates"). For example, a national bank could issue a digital certificate verifying a customer's current account balance. The rule pertains to certificates that contain the verified information and is not a general authorization for system-linked certificates.
- **Data Processing.** The rule codifies the OCC's authorization for a national bank to collect, process, transcribe, analyze and store banking, financial and economic data for itself and its customers as part of the business of banking. The rule clarifies that permissible processing of data includes provision of data processing services, data transmissions services, facilities, databases and advice and access to such services. "Economic data" is defined to include anything of value in banking and financial decisions. The rule also authorizes national banks to process additional types of data (i.e., non-financial) to the extent that such processing is "convenient or useful" to the bank's provision of banking, financial and economic data processing services. The bank's total revenue from providing data processing services must come predominantly from the processing of banking, financial and economic data.
- **Correspondent Services.** The rule codifies the OCC's long-standing position that a national bank may perform for any of its affiliates or any other financial institution any activity that a national bank may perform for itself. The OCC has previously approved many electronic and technology related activities as permissible correspondent services and these are included in the rule as examples of electronic activities that banks may offer as correspondent services.

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LOCATION OF A NATIONAL BANK CONDUCTING ELECTRONIC ACTIVITIES

The rule provides that a national bank will not be considered to be located in a state solely because it physically maintains equipment or facilities needed for electronic processing in the state or because the bank's products or services are accessed through electronic means by customers located in the state. While the rule does not specifically define what constitutes a bank's location, it makes clear that the location of equipment or customers does not alone determine the bank's location.

The rule stipulates for national banks that have no physical branches (i.e., Internet banks), the main office of the bank is that identified in its organization certificate. Such banks may charge interest on loans in accordance with the laws of the state in which the main office designated on the certificate is located.

SHARED ELECTRONIC SPACE

In order to avoid customer confusion, a national bank sharing electronic space with a third-party must take reasonable steps to clearly, conspicuously and understandably distinguish between products and services offered by the bank and those offered by an affiliated and non-affiliated third-party. In determining if reasonable steps have been taken, the OCC will review web page formatting, text or audio narratives and compliance with other product-specific regulatory disclosure requirements.

The final rule can be found at <http://www.schwartzandballen.com/WhatsNew.htm>.

If you have any questions concerning this rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.