DECISION OF THE OFFICE OF THE COMPTROLLER OF THE CURRENCY
ON THE APPLICATION TO CHARTER
COMPUBANK, NATIONAL ASSOCIATION, HOUSTON, TEXAS

AUGUST 20, 1997

I. DESCRIPTION OF THE PROPOSAL

On August 27, 1996, a group of individuals ("the Organizers") filed an application to charter a new national bank. The proposed bank will be headquartered in Houston, Texas, and will be titled CompuBank, National Association ("Bank"). The application has been supplemented from time to time with additional or amended information. No comments were received from the public regarding this application.

This is the first charter proposal filed with the OCC for a national bank that will deliver products and services to customers primarily through electronic means. The Bank will not have any traditional banking offices. In addition to using the mail, customers will conduct their banking transactions by using a personal computer or by telephoning the automated voice response system or customer service line. Initially, the Bank does not plan to offer banking transactions via the Internet, but will likely add that delivery option in the near future. The Bank has applied to the Federal Deposit Insurance Corporation (FDIC) for deposit insurance and will become a member of the Federal Reserve System.

The Bank will focus exclusively on offering checking and savings accounts and electronic bill payment services. Bank customers will deposit funds into their accounts through direct deposit, wire transfers, or mail. Customers will use an ATM/debit card and existing ATM networks to make withdrawals.

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1The Organizers are Frank S. Goldberg, Edward J. Crawford, Joseph W. Kaplan, Irving Pozmantier, and Nathaniel C. Morgan. All of the Organizers with the exception of Mr. Morgan will serve on the Bank's board. Two non-Organizers with backgrounds in technology and information services will also serve on the Bank's board. They are Jeffrey D. Hoffman and Jonathan H. Lack.
The Bank will not make or purchase any loans. Instead, it will invest funds primarily in high-grade U.S. Treasury and U.S. Government-sponsored agency securities. All investments will be made pursuant to the OCC’s Investment Securities Regulation (12 C.F.R. Part 1).

The initial primary service area for the Bank will be the metropolitan Houston market. The proposed Bank’s use of technology, however, could allow its customer base to expand regionally and nationally. The Bank has defined its target market as individuals who are younger (age 18 to 49), own a personal computer, and frequently use ATMs. Its marketing strategy combines offering low- or no-fee electronic banking with more personalized customer service.

The Bank’s main office, and initially its only office, will be situated in an office suite in Houston, Texas. The office will be designed as a “call center” reached primarily by telephone or computer, and it is not expected to have frequent walk-in customers. In the event that a customer chooses to visit the Bank’s office, he or she will be able to make new account or customer service inquiries, but will not be able to conduct cash transactions. Bank staff will consist of a President/Chief Executive Officer, a Chief Technology Officer/Cashier, a computer systems administrator, and customer service representatives.

The Bank, similar to traditional community banks or those offering electronic banking products, will perform some key operational functions internally while contracting with third-party service providers for the provision of other functions. Bank staff will provide customer service, investment, cashier, and regulatory compliance functions. Internal and external audit functions will be provided by outside companies on a contract basis. With respect to technology, the Bank will employ a client/server network architecture and will license existing banking software customized for its own needs. The proposed architecture will offer the Bank the flexibility to conduct its electronic customer interface and core data processing either “in-house” or through an outside service bureau arrangement. The Bank plans to contract with outside vendors to provide support for electronic bill payment services, ATM network services, and debit card operations.

II. LICENSING FACTORS

A. Policy Considerations

Under its Corporate Activities regulations (12 C.F.R. § 5.20), the OCC considers whether the proposed bank: (A) has organizers who are aware of, and understand, national banking laws and

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2 The electronic customer interface, or the “front-end,” facilitates the interaction between the customer’s computer and the Bank and that, in turn, allows the customer to perform tasks such as querying account balances, transferring funds between accounts, and paying bills. The core data processing, or “back-end,” involves the Bank’s posting of transactions to the appropriate accounts and to the general ledger and performing related functions such as internal reporting and customer account statement rendering.
regulations, and safe and sound operations and practices; (B) has competent management, including a board of directors, with ability and experience relevant to the types of services to be provided; (C) has capital that is sufficient to support the projected volume and type of business; (D) can reasonably be expected to achieve and maintain profitability; and (E) will be operated in a safe and sound manner.

In evaluating this charter proposal, the OCC performed a thorough analysis of the proposed operating plan. This included a field investigation with interviews of the proposed organizers, directors, and officers; evaluation of the Bank’s proposed information system architecture and approach to security and controls; discussions with OCC examiners and other Federal banking agencies regarding their experience with existing financial institutions that have similar operational aspects; an on-site visit to a bank that delivers products via telephone; and a review of the OCC’s ongoing research involving developments in electronic banking and payment systems technology.

The OCC’s field investigation concluded that the Organizers are knowledgeable of, and understand, national banking laws and regulations and safe and sound operations. Three of the Organizers have served as either an officer, director, or principal shareholder of a national bank with combined banking experience totaling nearly 40 years. Each Organizer understands the roles and responsibilities of a national bank director, and is knowledgeable of banking concepts.

The proposed Bank has competent management, including a board of directors, with abilities and experience relevant to the types of services to be provided. The proposed President is an experienced banker who has the necessary attributes to implement the proposed operating plan, including a good working knowledge of bank technology. He formerly served as the founding President of a profitable de novo community bank in Houston, Texas. The Bank has also named an experienced individual to serve as Chief Technology Officer and has proposed two additional directors who will bring valuable technology-related experience to the board.

Proposed capital is sufficient to support the projected volume and type of business. The Organizers intend to capitalize the Bank with $5.0 million, net of all organizational and pre-opening expenses. Based upon the Bank’s growth and earnings projections, this level of initial capital should ensure that the Bank’s Tier 1 leverage ratio will exceed eight percent throughout the first three years of operations. However, as outlined below, the OCC has imposed a condition requiring the Bank to maintain this level of capital in the event that earnings or growth differ from the original projections. The Organizers have the financial capacity and business contacts to provide additional capital if needed.

The proposed Bank can reasonably be expected to achieve and maintain profitability. Its strategy is to minimize overhead -- fixed assets, equipment, management, and personnel -- while offering a limited product line focusing exclusively on deposits and payment related services. The

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3 See 12 C.F.R. part 3 for the definition of Tier 1 capital and the leverage ratio.
Organizers supported the profit prospects of this strategy by including an independent feasibility study in the application. The financial projections show the Bank becoming profitable within three years using reasonable growth assumptions. In this regard, there appears to be a rapidly growing market for on-line banking services. A recent study predicted that the number of on-line banking users in the United States will more than double, to approximately 2 million users, by the Year 2000. Other researchers have reported that the U.S. on-line banking market is already at that level and may rise to 10 million or more users by 2000. Further, banks appear to be embracing the Internet. The OCC estimates that 840 U.S. banking organizations currently have Internet Websites, up from 440 sites only twelve months ago. While many of these Internet sites serve only as marketing tools at this time, the ability exists for banks to significantly increase the functionality of their sites. Surveys have also shown that on-line banking customers are some of banks’ most profitable customers, using more products and carrying higher average balances. The proposed Bank plans to attract this customer segment by offering its products and services with low or no fees and by providing more personalized customer service.

There are reasonable prospects that the Bank will attract its proposed customer base notwithstanding its limited product scope. The retail banking industry has experienced disintermediation in recent years with credit products such as automobile and credit card loans now being originated by focused, specialty banks or nonbanking companies. These loans often bear no relation to the consumer’s depository institution. The Bank, by focusing only on the consumer’s deposit and bill payment needs, will pursue a business strategy consistent with this industry trend. Further, until recently, this model would not have been economically viable, but the emergence of lower cost delivery channels such as personal computers, telephones, and ATMs, creates the potential for a profitable bank.

The OCC is satisfied that the Bank will be operated in a safe and sound manner. As part of the operating plan submitted to the OCC, the Organizers have outlined the proposed information system and operations architecture. This includes a draft schematic drawing and description of the system and discussion of the technology alternatives for each product/service line and the key requirements for the proposed security controls, internal controls, and audit procedures. Based upon our review of the plans, the OCC is satisfied with the controls being proposed to date, but will continue to monitor developments during the organizational phase of the Bank.

As is typical for a new bank charter proposal that has not yet received the OCC’s preliminary approval, the Organizers and proposed management have not made the final hardware, software, and vendor selections and purchase commitments. The final information system and operations architecture will not be known until after the Bank makes these decisions. As a result, prior to receiving final charter approval, we are requiring the Bank to submit the final information system and operations architecture plans for the OCC’s review and approval. In addition, before

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4 The American Banker, June 12, 1997, p. 18.

5 Consumer Demand for Internet Banking, Booz-Allen Hamilton, Inc., July 1996.
implementation, the Bank’s computer system must successfully undergo a full functionality and security review by an independent security firm, including attempts to gain unauthorized or undetected access. After this review has been completed and the Bank has satisfied all pre-opening requirements, the OCC will conduct a thorough pre-opening examination of the Bank and its information systems environment and will decide whether to grant final charter approval.\(^6\) Once the Bank is opened, for the first three years and until it becomes profitable, we are requiring it to present to the OCC, for prior review and approval, any major changes in its strategic or operating plans, including, but not limited to, plans to offer banking services via the Internet.

The Organizers have made several representations regarding the proposed Bank’s operations. They have represented that the Bank’s internal systems will be Year 2000 compliant and that the proposed Bank will perform due diligence to ensure that any third-party data processing services or purchased applications or systems from software vendors will also be Year 2000 compliant.\(^7\) In addition, each vendor will certify its Year 2000 compliance through covenants in the vendor contract. Finally, the Organizers represent that the Bank will not indicate in any of its marketing efforts or materials that the OCC has approved or endorsed the security, functionality, or effectiveness of the Bank’s products or services.

Additionally, the OCC plans to issue by late 1997 guidance for national banks on remote banking. The guidance will lay out goals and objectives and communicate information to help national banks, including the proposed Bank, identify and manage the risks presented by electronic delivery channels. The primary focus will be on security precautions used to protect and verify customers’ identification and transaction information, as well as to protect the system architecture. The OCC will expect the Bank to adhere to this future guidance.

Inclusive of the pre-opening requirements and supervisory conditions outlined below, the OCC believes that the Bank has a reasonable chance for success and can be adequately supervised using established safety and soundness and bank information system examination procedures.

B. Community Reinvestment Act Considerations

Under the Community Reinvestment Act (CRA) regulations, the OCC must take into account a proposed insured national bank’s description of how it will meet its CRA objectives. (see 12 C.F.R. part 25). The Bank’s operating plan includes such a description. Since the Bank

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\(^6\) The Bank’s operating plan, including any future additions or revisions, will provide the context for the supervisory review during the pre-opening examination. The OCC will work closely with the Bank as its actual operations develop as part of the pre-opening examination process. Major deviations from the operating plan or changes in the composition of the board of directors, ownership, or executive officers that the OCC has not approved may result in withdrawal of preliminary conditional approval.

\(^7\) For a discussion of bank regulatory concerns and guidelines for banks regarding Year 2000 system issues, see OCC Advisory Letter 97-6 (May 16, 1997) and the FFIEC Interagency Statement.
proposes to focus on offering deposit products and payment related services (i.e., electronic bill payment) with no lending products to be offered to the public or to be purchased from other institutions, it has requested to be designated as a limited purpose bank for evaluation under the CRA. Under the CRA regulation (12 C.F.R. § 25.12(o)), a limited purpose bank is defined as “a bank that offers only a narrow product line (such as credit card or motor vehicle loans) to a regional or broader market. . . . ”

The OCC assesses a limited purpose bank’s record of helping to meet the credit needs of its assessment area under the community development test through its community development lending, qualified investments, and community development services. (see 12 C.F.R. § 25.25). The Bank plans to delineate the Greater Houston MSA as its assessment area, and to serve this community by making qualified investments and providing community development services as defined in the CRA regulations. Consistent with the Bank’s alternative delivery channel approach, it plans to focus its CRA efforts in the areas of personal computer availability and access to on-line banking services for low- and moderate-income (LMI) individuals. The Bank’s efforts will be centered upon making its services “responsive to the needs of low- and moderate-income areas and individuals.” It will seek qualified investment and community development service opportunities relating to providing computers and computer literacy training through schools in LMI areas. It will also seek qualified investment and community development service opportunities such as Minority Enterprise Small Business Investment Companies, credit counseling, small business incubation projects, and special bonds designed to offer mortgage loans to LMI individuals within the assessment area.

Based upon a review of the proposed operating plan, the OCC has determined that the proposed Bank will not make loans which are traditionally evaluated under the CRA, and, accordingly, has approved the Bank’s request for designation as a limited purpose bank for evaluation under the CRA. Further, the activities that the Bank proposes as possible investments will likely meet the definition of qualified investments under the CRA Regulations (12 U.S.C. § 25.12). The OCC believes that the Bank’s plan for meeting its CRA objectives is consistent with preliminary approval for this charter application.

C. Legal Considerations

The OCC charts a national bank under the authority of the National Bank Act of 1864, as amended, 12 U.S.C. § 1 et seq. There is no impediment under the National Bank Act to granting this preliminary charter approval.  

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8 The limited purpose bank designation will remain effective until the bank requests revocation or until one year after the OCC would notify the Bank that it has revoked the designation. The Bank would no longer qualify for such a designation if it begins to make loans which are traditionally evaluated under the CRA.

9 The statutory requirements for chartering a national bank under the National Bank Act are as follows: articles of association and an organization certificate must be drafted and filed with the OCC, 12 U.S.C. §§ 21-23;
The Bank has indicated in its application that certain core functions of its internal operations as well as the operation of the computer interface with customers will be contracted out to various vendors. The process of subcontracting activities for which the bank would otherwise be responsible to perform itself implicates the requirements of the Bank Service Company Act, 12 U.S.C. § 1861 et. seq. In particular, 12 U.S.C. § 1867(c) states that

> notwithstanding subsection (a) of this section, whenever a bank that is regularly examined by an appropriate Federal banking agency, or any subsidiary or affiliate of such bank that is subject to examination by that agency, causes to be performed for itself, by contract or otherwise, any services authorized under this chapter, whether on or off its premises - (1) such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself on its own premises . . . .

Pursuant to this statute, services performed for the Bank by contract or otherwise, including but not limited to the provision of electronic customer interface processing, core data processing, electronic bill payment services, ATM network services, and debit card operations, will be subject to the examination and regulation of the OCC. The Bank has represented that it will notify potential vendors, in writing, of the OCC’s examination and regulatory jurisdiction should they contract with the bank. This understanding regarding OCC jurisdiction will be included in all vendor contracts. Accordingly, subcontracting these functions to a vendor will not frustrate the OCC’s ability to regulate all aspects of the bank that could affect its safe and sound operations.

### III. PRE-OPENING REQUIREMENTS AND SUPERVISORY CONDITIONS

In all cases, following review of a new bank charter application, the OCC decides whether to grant preliminary approval, preliminary conditional approval, or disapproval to the request. Preliminary approval indicates permission to proceed with the organization of the bank according to the plan set forth in the application. The organizational steps of a new national bank generally include hiring management and staff, establishing premises, purchasing computers and other equipment, selecting vendors, developing and implementing policies, procedures, and controls, and raising capital. Preliminary approval is not an assurance, however, that the OCC will grant a new national bank charter. Once the OCC grants preliminary approval to a charter proposal, the organizing group must satisfy certain procedural requirements, and in some cases special requirements, before the OCC will grant final charter approval. In addition, the OCC sometimes imposes conditions that will remain in place after the bank opens.

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the required amount of capital must be paid in, 12 U.S.C. § 53; certain requirements relating to directors must be satisfied, 12 U.S.C. §§ 71-73; and the OCC must be notified when these things have been accomplished, 12 U.S.C. § 26. As is typical with new charter proposals, these requirements will be satisfied after the OCC grants preliminary approval.
In this proposal, the OCC has decided to grant preliminary conditional approval subject to several pre-opening requirements and on-going supervisory conditions. These supplement the procedural requirements for a new national bank referenced in the attached transmittal letter to the Bank’s spokesperson. The pre-opening requirements provide a framework for steps that the Organizers must successfully complete before the OCC can render a decision on final charter approval. The on-going supervisory conditions primarily establish certain checks and safeguards to ensure that the Bank, once open, will appropriately manage and control the relevant risks, maintain adequate capital, and operate in an overall safe and sound manner. The majority of the conditions will remain in place for the first three years of operation or until the Bank becomes profitable, whichever is later. After this time period, all but two of the conditions will expire. The OCC will monitor the Bank’s future actions and performance through the normal supervisory process.

The following requirements must be satisfied before the OCC will grant final charter approval:

1. The Bank’s initial Tier 1 capital, net of all organizational and pre-opening expenses, shall be no less than $5.0 million.

2. No later than 90 days before the Bank is scheduled to open, the Bank must submit to the OCC for review and approval a complete description of the Bank’s final proposed information system and back office operations architecture. This should also include a discussion of the following items: proposed vendors; due diligence performed on the prospective third-party vendors; draft vendor contracts and draft notices pursuant to Supervisory Condition #3; operating processes; security controls; internal controls; and internal audit plans. This information must be considered satisfactory to the OCC before the Bank enters into final contracts and before the OCC will grant final charter approval.

3. The Bank, if it decides to implement an in-house core data processing system, shall name an individual to serve in a back-up role to the systems administrator.

4. The Bank shall cause to be performed an independent, full functionality and security review of its computer banking platform prior to initial implementation. This review must be conducted by an independent computer-security specialist, and the scope of the review must be pre-cleared by the OCC. The specialist should confirm by written report that the individual hardware and software components are well integrated and that the security measures set forth during the system design phase have been satisfactorily implemented and tested by various means to measure their effectiveness. Further, the report should confirm with reasonable certainty that the computer system allows neither unauthorized nor undetected access. The OCC will consider the results of the report as well as any subsequent actions by the Bank to implement recommendations or to remedy any noted security or control deficiencies, as part of its decision to grant final charter approval.

5. Prior to opening, the Bank must engage an independent, external auditor to perform an audit according to generally accepted auditing standards of sufficient scope to enable the
auditor to render an opinion on the financial statements of the Bank (or consolidated holding company), taken as a whole. The audit period must commence on the date that the organizing group forms a body corporate and may end on any calendar quarter-end no later than 12 months after the Bank opens. We expect that such audits will be performed on an annual basis for at least three years following commencement of operations. Engagement of an auditor will be verified during the pre-opening examination.

6. The Bank must receive all required regulatory approvals, including deposit insurance from the FDIC and membership in the Federal Reserve System.

Final approval will be subject to the following supervisory conditions:

1. During its first three years of operations, the Bank shall at all times maintain a ratio of Tier 1 capital to adjusted total assets, as defined in 12 C.F.R. § 3.2, in an amount that is equal to or greater than 8.0 percent.

2. During the Bank’s first three years of operations or until it becomes profitable for two consecutive quarters, whichever is later, the Bank shall not make major changes in its strategic or operating plans without the prior approval of the OCC. This shall include, but not be limited to, offering banking services via the Internet, offering stored value card services, introducing loan products, and establishing bank premises for customer service. The Bank shall provide the Deputy Comptroller for the Southwestern District with a written request for OCC’s prior approval of any such changes. The request shall include:

   • a general description of and reason for the change;
   • vendor contracts, if applicable;
   • a description of the security and internal controls governing the new activity;
   • the impact, if any, on staffing and operating expenses, and on the Bank’s balance sheet, income statement, and regulatory capital ratios;
   • the impact on the Bank’s CRA designation and plans, if applicable; and
   • a revised strategic plan that includes the proposed change.

The OCC will act on the proposed change within 30 days of receipt of the written request, unless the OCC, in its sole discretion, decides that additional time is needed.

3. The Bank shall notify all potential vendors in writing of the OCC’s examination and regulatory authority under 12 U.S.C. § 1867(c). The Bank must submit the draft notices to the OCC for its prior review and approval before disseminating the notices to vendors. All final vendor contracts shall stipulate that the performance of services provided by the vendors to the Bank is subject to the OCC’s examination and regulatory authority.

4. Stock options issued to Bank organizers, directors, and executive officers must include the following legend:
If CompuBank, N.A.’s Tier 1 capital falls below the minimum requirements contained in 12 C.F.R. Part 3, or falls below a higher requirement as determined by the OCC in connection with a cease and desist order, consent order, formal written agreement, or Prompt Corrective Action directive (See 12 C.F.R. Part 6, Subpart B), the OCC may direct CompuBank, N.A. to require option holders to exercise or forfeit their options. CompuBank, N.A. will notify option holders within 45 days from the date the OCC notifies the bank in writing that option holders must exercise or forfeit their options. CompuBank, N.A. will cancel options not exercised within 21 days of CompuBank, N.A.’s notification. CompuBank, N.A. has agreed to comply with the OCC’s request that CompuBank, N.A. invoke its right to require option holders to exercise or forfeit their options under the circumstances stated above.

The above listed conditions of this approval shall be deemed to be conditions "imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 U.S.C. § 1818(b)(1).

V. CONCLUSION

The charter proposal satisfies the applicable statutory requirements of the National Bank Act and the supervisory and general policy standards of the OCC, as set forth in 12 C.F.R. § 5.20. For the reasons set forth above, including the representations and commitments made by the applicants, it is my conclusion that this proposed national bank has a reasonable likelihood of success. Accordingly, the application is hereby preliminarily approved, subject to the requirements and conditions outlined in this Decision Document and the transmittal letter.

/s/ 08-20-97
Julie L. Williams Date
Chief Counsel

Application Control Number: 96-WO-01-0003