



Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

Corporate Decision #2002-11
July 2002

June 28, 2002

Richard E. Brophy, Jr.
Naman, Howell, Smith & Lee
P.O. Box 1470
Waco, TX 76703

Subject: Operating Subsidiary Application by Extraco Bank, N.A., Waco, TX to Expand Activities of Extraco Institutional Services Corp., Application Control Number: 2002-WO-08-0002

Dear Mr. Brophy:

Extraco Bank, N.A., (the "Bank"), Waco, TX has filed an application under 12 CFR § 5.34 to expand the scope of activities performed by an operating subsidiary of the Bank, Extraco Institutional Services Corporation (the "Company"). The Company proposes to provide advisory and consulting services to Bank customers who use the Bank's electronic retail or wholesale transactional services; the advice would cover the hardware, software, and other technologies necessary to use those services. The Company also proposes to provide advisory and consulting services to business customers on the hardware, software, and other technology necessary to enable those customers to process for themselves banking, economic, and financial information. Based on the commitments and representations in the Bank's application and other materials, the expanded activities of the Company are approved.

Background

Currently, the Company is engaged in a wide range of activities providing support for the Bank and its affiliates in their lending operations, internal training, human resources, marketing, cash management and deposit operations, and information systems. However, in light of its significant capital expenditures and human resource acquisitions to improve the Company's technological service capacities, the Bank would like to use the Company's competence to offer technology-related advisory and consulting services to the Bank's retail and small business customers. Specifically, the Bank now proposes that the Company engage in three new activities.

First, the Company would provide advisory and consulting services to Bank retail customers with regard to the installation of necessary hardware, software, telephone lines, modems and

other devices in order to operate the Bank's Internet-based home banking product. The Bank has found that many of its customers, particularly elderly customers, wish to use the Bank's electronic home banking product, but lack the expertise and knowledge to install the necessary hardware and software needed to make the Bank's home banking product operational.¹ Accordingly, the Bank believes that to more successfully market its home banking service, it needs to provide customers with advice and consultation on the technology (including installation and maintenance) needed to operate that Internet home banking service.

Second, the Company would provide advice and consultation to the Bank's wholesale and business customers with regard to the hardware, software, telephone lines, and other devices necessary to use the Bank's Internet-based cash management and ACH services. The Bank states that in order to provide the electronic cash management and ACH services to business customers, it has found that many customers require advice and consultation with regard to the technology needed to maintain and operate those services. In order for the Bank's customers to install and integrate with the banking products, the Bank has periodically been asked to assist its customers with their information technology needs. The Bank has concluded that if it is unable to provide such advice and consultation to its small business customers, it will be unable to market effectively its Internet-based cash management and ACH services.

Third, the Company would provide advice and consulting services to Bank business customers on the processing of banking, financial, and economic data for themselves, including the hardware and software needed to enable customers to process such data.² The Bank represents that such banking, financial, and economic data would include accounts receivable, accounts payable, revenues, expenses, and similar financial data. The advisory and consulting services would be limited to the type of banking, financial, and economic data that the Bank would be permitted to process on behalf of its customers. See 12 CFR § 7.5006. The Bank asserts that the proposed consulting activities will respond to a clear customer need and will assist the Bank because it will enable a customer to set up data processing systems that provide the kind of information needed by both the Bank and the customer for transactions between the Bank and the customer. The Bank has found that many of its small business customers lack the resources to design, install, and maintain their information technology systems. Further, the Bank has found that, in connection with providing traditional bank products such as deposit products and loans, it is essential that its customers have information technology systems that function properly.

¹ The Bank notes that elderly people have been identified as the fastest-growing segment of Internet users. S. Berger, "The Web Welcomes Older Women," Technology News (July 18, 2000). See also Press Release, Microsoft Corp. and National Council on Aging (Sept. 4, 1998) (Americans over age 60 represent the fastest-growing segment of computer and Internet users).

² This would include advice and consultation with regard to information system design, network and computer administration, software and hardware installation and maintenance, and telecommunications installation and maintenance to the extent necessary to enable the customer to process banking, financial, or economic data.

The Bank acknowledges that providing the proposed technology advisory services may increase risks, particularly if the Company fails to render accurate advice. However, the Bank believes it can adequately limit and control these risks. To that end, the Bank commits that it and the Company will: 1) document the advice given to clients, 2) obtain appropriate insurance coverage, 3) ensure that staff providing advice is competent, trustworthy, and has appropriate professional credentials, 4) limit the areas in which advice given to those in which the Company's personnel have sufficient training and experience, 5) avoid any management role regarding or operating control over customers by limiting the role of Company personnel to advice and consultation and by leaving decisions to the customer's management, and 6) enter into appropriate engagement letters to define the scope of proposed services and limit the Company's liability for such services.³

The Bank commits that it will not directly offer any data processing to its customers and thereby will avoid the possible conflicts of interest that could arise between the Bank's advisory activities and its role as a direct provider of data processing services. Moreover, the advice and consultation provided by the Company will relate to products offered by third-party providers. The Bank has represented that neither the Bank nor the Company currently have or plan to enter into any relationships with third-party software or hardware providers under which the Bank will 1) endorse or recommend third party products or 2) receive special incentives in compensation for sales of such products. The Company's recommendations with regard to hardware will be made based upon a customer's existing hardware or the customer's preference. If the customer has no existing hardware or preferences, the Company likely will recommend hardware with which it is most familiar, although neither the Bank nor the Company has any arrangements or agreements to recommend specific hardware.

Discussion

The OCC recently adopted a final regulation on electronic activities of national banks. Among other things, this regulation codified the existing OCC position on a national bank's authority to engage in data processing activities. The new regulation provides in relevant part:

It is part of the business of banking under 12 U.S.C. § 24(Seventh) for a national bank to provide data processing, and data transmission services, facilities (including equipment, technology, and personnel), data bases, advice and access to such services, facilities, data bases **and advice**, for itself and for others, where the data is banking, financial, or economic data, and other types of data if the derivative or resultant product is banking, financial, or economic data. For this purpose, economic data includes anything of value in banking and financial decisions.

12 CFR § 7.5006(a) (emphasis added). This rule codifies OCC interpretations confirming that a national bank may collect, process, transcribe, analyze, and store banking, financial, and

³ On larger projects, the Company plans to enter into engagement letters that contain provisions limiting the liability of the Company to the amount paid for services.

economic data for itself and its customers as part of the business of banking.⁴ The new rule clarifies that permissible “processing” of eligible data includes provision of data processing services, data transmission services, facilities (including equipment, technology, and personnel), data bases and advice. It also includes providing access to such services, facilities, data bases, and advice. Finally, the rule specifies that for purposes of this section, “economic data” includes anything of value in banking and financial decisions.⁵ We find that the Company’s proposed advisory and consulting activities are permissible under this regulation and the underlying OCC and judicial precedent supporting the rule.

The new rule and OCC precedent authorize national banks to provide advice with respect to data processing and data transmission services, facilities (including equipment, technology, and personnel) and data bases provided that the underlying data is banking, financial, or economic data. The OCC has held that where a bank would be permitted as part of the business of banking to provide a service and related expertise to an entity, the bank should also be permitted, as part of the business of banking, to employ that expertise to provide advice to that entity as to how the entity can perform the service for itself. See OCC Interpretive Letter No. 928 (December 24, 2001) and the authorities cited therein.

Here, all three of the proposed advisory services entail providing advice on the processing of banking, financial, or economic data. The Company proposes to advise retail and wholesale Bank customers, who use the Bank’s electronic transactional services, on the hardware, software, and other technologies necessary to use those services. Such advice is clearly focused on the processing of banking data.⁶ The Company also proposes to provide advisory

⁴ See, e.g., OCC Conditional Approval No. 289 (Oct. 2, 1998); OCC Interpretive Letter No. 805, reprinted in [1997-1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,252 (Oct. 9, 1997). A prior OCC interpretive ruling on electronic banking specifically stated that “as part of the business of banking and incidental thereto, a national bank may collect, transcribe, process, analyze and store for itself and others, banking, financial, or related economic data.” 39 FR 14192, 14195 (Apr. 22, 1974). This language was deleted from former 12 CFR § 7.3500 because the OCC was concerned that the specific examples of permissible activities in the ruling, such as the marketing of excess time, by-products, and the processing of “banking, financial, or related economic data,” had led to confusion and misinterpretation. See 47 FR at 46526, 46529 (Oct. 19, 1982). However, the preamble stated “the Office wishes to make clear that it does not intend to indicate any change in its position regarding the permissibility of data processing services.” Id. Since 1982, the risk of confusion and misinterpretation of a regulation has significantly diminished due to, among other reasons, the substantial number of interpretive letters the OCC has issued on permissible data processing that can provide a context for understanding the rule.

⁵ See, e.g., Association of Data Processing Service Organizations, Inc. v. Board of Governors, 745 F.2d 677, 691 (D.C. Cir. 1984).

⁶ The new regulation also codifies the long established rule that an electronic banking activity is authorized for a national bank as incidental to the business of banking if it is convenient or useful to an activity that is specifically authorized for national banks or to an activity that is otherwise part of the business of banking. In determining whether an activity is convenient or useful to such activities, the regulation provides that OCC will consider, among other things, “whether the activity facilitates the production or delivery of a bank’s products or services, enhances the bank’s ability to sell or market its products or services, or improves the effectiveness or efficiency of the bank’s operations, in light of risks presented, innovations, strategies, techniques and new technologies for producing and delivering financial products and services....” 12 CFR § 7.5001(d)(1)(i). While this need not be decided today, the

and consulting services to business customers on the hardware, software, and other technology necessary to enable Bank customers to process banking, economic, and financial information for themselves. This would include processing of information on the customer's accounts receivable, accounts payable, revenues, expenses, and similar financial data. The Bank has committed that it will limit its advisory and consulting services to the type of banking, financial, and economic data that the Bank would be permitted to process on behalf of its customers.

The new regulation provides that the "OCC may determine that activities are permissible under 12 U.S.C. § 24(Seventh) or other statutory authority only if they are subject to standards or conditions designed to provide that the activities function as intended and are conducted safely and soundly, in accordance with other applicable statutes, regulations, or supervisory policies." 12 CFR § 7.5001(b). The Company's proposed activities do raise additional risks, but we conclude that the Bank can ensure the activities are conducted in a safe and sound manner.

The OCC has recognized that banks offering technical advice may need to take special precautions. We have said:

The advising bank would potentially be liable if it failed to render competent advice. Accordingly, we would expect advising banks to take suitable steps to control that risk, such as keeping adequate records of the advice rendered, obtaining appropriate insurance coverage, and ensuring that the staff rendering the advice is competent, trustworthy, and has appropriate professional credentials. Moreover, we would expect that generally a bank would only render advice on banking services that it has actual direct experience in performing adequately. This would not generally include, for example, a bank that has relied upon outsourcing for an activity. Additionally, when acting in an advisory or consulting capacity, a bank should not actually engage in a management role or exercise any form of operating control over the advisee. Finally, banks providing advisory services should be careful to define clearly in their engagement letters or agreements the scope of advice rendered and the bank's liability for that advice.

OCC Interpretive Letter No. 928, supra, N. 17. The Bank has committed that it will adopt these precautions.

Another risk in rendering advice may arise from the failure to appropriately manage potential conflicts of interest between the advising bank and its client. Conflicts of interest arise when an advisor's ability to act exclusively in the best interests of a client is impaired by the interests of the advisor or a related party. Thus, the code of ethics for many institutes and associations

Company's technical advice with respect to the use of the Bank's electronic home banking, CMA, and ACH services would appear to be incidental to the offering of those banking services.

for technology consultants urge their members to avoid conflicts of interest and to disclose conflicts to affected parties when they arise.⁷

For example, conflicts of interest could arise if the Company had an incentive to recommend particular systems or configurations because it would receive finder fees from system providers or because certain system configurations would facilitate the Bank's ability to conduct banking business with the consulting client. The Bank has represented that neither the Bank nor the Company have or plan to enter into any relationships with third-party software or hardware providers to endorse or recommend their products or that provide for any special incentives in compensation for sales. Similarly the OCC expects that the Company will disclose to consulting clients any other situations where the Bank has an interest in promoting specific system configurations or technologies.⁸

Conclusion

Accordingly, based on the foregoing, the Bank's application to expand the activities of the Company is approved.⁹

A separate letter is enclosed requesting your opinion of our service in processing your applications. We would appreciate your response so we may evaluate our service. In the event of questions, please contact Steven Strasser, Licensing Analyst, at (202) 874-5060.

Sincerely,

-signed-

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

⁷ See, e.g., the codes of ethics for the Institute of Electrical and Electronic Engineers (www.ieee.org/about/whatis/code.html), Independent Computer Consultants Association (www.icca.org/ethics.asp), and the National Bureau of Certified Consultants (www.national-bureau.com/html/code_of_ethics.html).

⁸ For example, in the third type of proposed advisory activity (advice on processing financial data including on system architecture) to small businesses, conflict situations might arise where the Bank's ability to provide *banking* services to the client would be facilitated if the client adopted one particular architecture over others. However, in the first two types of proposed activities (advice to existing home banking and CMA customers), there would be no need for such conflict disclosures because the customers would be specifically seeking advice on how best to connect electronically to receive services from the Bank.

⁹ This approval, and the activities and communications by OCC employees in connection with the filing, do not constitute a contract, express or implied, or any other obligation binding upon the OCC, the U.S., any agency or entity of the U.S., or an officer or employee of the U.S., and do not affect the ability of the OCC to exercise its supervisory, regulatory, and examination authorities under applicable law and regulations. The foregoing may not be waived or modified by any employee or agent of the OCC or the U.S.